REPORTABLE

IN THE TAX COURT, CAPE TOWN

In the matter between:

CASE NO.: 11935

Appellant

and

COMMISSONER: SOUTH AFRICAN

REVENUE SERVICE Respondent

JUDGMENT

(Heard in Cape Town on 9 October 2006)

(Judgment delivered on 9 October 2006)

BINNS-WARD, AJ:

At issue in this appeal brought in terms of s 83 of the Income Tax Act 58 of 1962 is whether the appellant is a 'personal service company' as defined in paragraph 1 of Part I of the Fourth Schedule of the Act.

The issue has arisen because the Commissioner acting in terms of s 23 (k) of the Act has in respect of the 2002 and 2003 years of assessment disallowed certain expenses as deductions from the gross income of the appellant.

Personal service company is defined as meaning:

‘ *any company (other than a company which is a labour broker), where any service rendered on behalf of such company to a client of such company is rendered personally by any person who is a connected person in relation to such company,*

and-

(a) *such person would be regarded as an employee of such client if such service was rendered by such person directly to such client, other than on behalf of such company; or*

(b) *such person or such company is subject to the control or supervision of such client as to the manner in which, or hours*

during which, the duties are performed or are to be performed in rendering such services; or

(c) *the amounts paid or payable in respect of such service consist of, or include, earnings of any description which are payable at regular daily, weekly, monthly or other intervals; or*

(d) where more than 80 per cent of the income of such company during the year of assessment, from services rendered, consists of or is likely to consist of amounts received directly or indirectly from any one client of such company, or any associated institution as defined in the Seventh Schedule to this Act, in relation to such client,

except where such company throughout the year of assessment, employs more than three full-time employees who are on a full-time basis engaged in the business of such company of rendering any such service, other than any employee who is a shareholder or member of the company or is a connected person in relation to such person.'

The qualifying criteria set out in paragraphs (a) to (d) of the definition have been stated disjunctively and accordingly, assuming that the relevant service rendered on behalf of the company has been rendered by a connected person in relation to that company to a client of the company, the company falls within the definition if it satisfies any one of the four qualifying criteria unless it falls within the exception provided in respect of companies employing more than three fulltime employees.

For completeness I should perhaps mention that the appellant is a close corporation incorporated as such in terms of the Close Corporations Act, 69 of 1984. A close corporation is included within the ambit of 'company' as defined

in s 1 of the Income Tax Act. The term ‘connected person’ as defined in s 1 of the Act connotes in relation to a close corporation, amongst other things, any member of the close corporation.

It is common cause that in the years in question the appellant had either four, or after the demise of one of the former, three members. It was also common cause that during the relevant period the appellant derived more than 80 per cent of its income in each year of assessment from services rendered to one of its clients, A.

During the 2002 year of assessment, 81 per cent of appellant’s income was in respect of services rendered by the appellant to A, and in 2003, 99 per cent.

It is also common cause that during the relevant period the appellant did not at any time employ more than three full-time employees.

It was also common ground that the services rendered by the appellant to A during the relevant periods were rendered by one or more of its members with the assistance of part-time employees.

Mr Mellor, who appeared on behalf of the appellant stressed that the appellant had been incorporated with the view to operating as an independent contractor. It was to be expected he said that in the X area where A is one of the largest users of services in the domestic economy that a large part of the income of any company in the appellant’s position would derive from A.

Mr Mellor submitted that the provisions of s 23(k) could not have been intended to apply to independent contractors.

Ms Rampersad who appeared for the Commissioner referred in her written heads of argument to the mischief at which the relevant provisions were directed with reference to a tendency during the 1990's for many employees to provide their services to employers through the vehicle of a company or close corporation in order to, as she put it, side step the imposition of employees tax while essentially fulfilling the role and functions of an employee and also to enable the deduction of expenses from the income of persons rendering services as employees as would not otherwise be deductible. The provisions that are relevant in the current matter were directed at discouraging the practice evident in the aforementioned trend.

It seems to me that the legislation may have cast the net wider than was necessary to address the mischief that it was intended to. The effect of paragraph (d) of the definition of 'personal service company' for example attracts the operation of the provision of s 23(k) in cases where the character of the small corporate service provider doing business through the vehicle of a close corporation, where all or most of the work is done by one or more of the members, might indubitably be that of an independent contractor as the concept is understood at common law (cf. e.g. *Colonial Mutual Life Assurance Society Ltd v Mac Donald 1931 AD* at 434 – 435: *Smit v Workmen's Compensation Commissioner 1979 (1) SA 51 (A)* and *FPS Ltd v Trident Construction (Pty) Ltd 1989 (3) SA 537 (A)* only because more than 80 per

cent of its income in any one year is derived from the provision of service to a single client.

I have some sympathy for the position in which the members of the appellant have found themselves as a consequence of the incorporation of their business, but it seems to me that there is no way of avoiding the conclusion that the Commissioner has correctly characterised the taxpayer as a 'personal service company' as defined in the Fourth Schedule. Accordingly it follows that the deductions claimed by the taxpayer in respect of the expenses during the 2002 and 2003 years of assessment were correctly disallowed.

There were no other grounds of attack on the revised assessments issued by the Commissioner and accordingly the appeal must be dismissed and the assessments confirmed.

This Judgment should be reported YES

Ms M Rampersad represented the Commissioner: SARS

Mr C Mellor instructed by LDP Inc. appeared on behalf of the Appellant.

A.G. BINNS-WARD

President of the Court