REPORTABLE

IN THE TAX COURT

BEFORE

The Honourable Ms Justice H K Saldulker President

Ernie Lai King Commercial Member

Younaid Waya Accountant Member

In the appeal of

CASE NO 11711

JUDGMENT

(Date of judgment 13 December 2006)

SALDULKER, J:

[1] The appellant, a qualified chartered accountant, commenced employment with A Pty Ltd ["A"] on 1 November 1995 in terms of an employment contract signed on 6 October 1995. She was employed as a structured finance specialist in the Bank Division of A which was acquired by B.

[2] During the tenure with B, as Head of the Business and Market Development Division she was approached by C, the CEO of B, to enter into a Restraint of Trade Agreement ("RTA"). These discussions took place in August 1999. Initially she refused to enter into the RTA as she considered that the amount of the RTA payment offered was not commensurate with the conditions and the effect of the RTA. A revised offer of R1.1 million was subsequently offered and accepted.

[3] On 27 October 1999 she signed a letter addressed to her by C confirming that she was fully acquainted with the content and the consequences of the RTA entered in between herself and the Bank. The letter recorded her willingness to be restrained and he understanding of the content and the consequences of the agreement was confirmed by her signature

at the bottom of the letter. The RTA was signed on 29 October 1999 by both appellant and C.

[4] In term of the RTA the amount of R1.1 million was payable as follows: an amount of R440 000 was paid on 25 October 1999 (The first tranche) and an amount of R660 000 was to be paid on 30 September 2001. (The second tranche).

[5] The appellant was retrenched on 17 August 2001. In a letter dated 17 August 2001, D, the Chief Executive of B, confirmed that the appellant's retrenchment was effective from 31 August 2001. Appellant made certain hand written amendment to that letter and signed the letter on 24 August 2001 stating that the second restraint of trade payment to the value of R660 000 was payable to her on 30 September 2001. In a letter dated 29 August 2001 D confirmed that the restraint of trade payment due on 30 September 2001 would be paid when it became due. On 1 October 2001 the RTA payment of R660 000 was deposited into the appellant's bank account.

[6] The first tranche was duly settled on the 25 October 2001. It is common cause that part of the payment of R440 000 includes an amount of R360 000 which was utilised to settle a

loan from B to the appellant. The loan had been advanced to the appellant to acquire shares in B in terms of a share incentive scheme. The balance of R80 000 was paid into the appellant's bank account on 3 November 1999.

[7] It is the payment of the first tranche, the amount of R440 00 on 25 October 1999 which forms the basis for the South African Revue Service (SARS) (Respondent) to question the genuineness of the agreement which was signed on 29 October 1999 and pre-empted by the signing of the letter on 27 October 1999.

[8] The appellant submitted her income tax return – form IT 12 S- for the 2000 tax year, on 28 August 2000 and in her return she declared:

> as "Restraint of trade receipts" – a total of R1, 100, 000 and as "Amount value of receipt" – first payment R440 000.

[9] The original assessment for the 2000 tax year was issued on 28 February 2001 with a due date 1 April 2001. The first

tranche of R440, 000 was not included in the taxpayer's gross income.

[10] This was also the case with the revised additional assessment for the same tax year dated 11 July 2001 with a due date of 1 September 2001.

[11] On 18 December 2003 the Commissioner issued an additional assessment in respect of the 2000 tax year with a due date of 1 February 2004 (the disputed assessment) which included the full amount of the restraint consideration, R1, 1 million in the gross income of the appellant for that year.

[12] In a letter dated 22 December 2003 the Commissioner advised the appellant that the R1, 1 million in respect of restraint trade payments was subject to tax in terms of the definition of Gross Income, in section 1 and the proviso to this section of the Income Tax Act no 58 of 1962, as amended" (The Act). No reference was made to any particular paragraph of the definition of gross income in terms of which the R1, 1 million was included.

[13] The appellant requested full reasons for this dispute assessment on 30 January 2004 and on 13 July 2004 responded advancing the same reason as contained in the letter of 22 December 2003. Again no reference was made to any particular paragraph of the definition of gross income in terms of which the R1, 1 million was included. Dissatisfied with the respondent's reasons the appellant requested reasons in terms of The Promotion of Administrative Justice Act No 3 of 2000 (PAJA), SARS responded as follows in a letter dated 2 September 2004:

> "1. The amount received/accrued by/to you in terms of the restraint of trade agreement entered into with B during the 2000 year of assessment of R1, 100,000.00 falls into paragraph (c) of the definition of "gross income" as defined in section 1 of the Income Tax Act number 58 of 1962, as amended, read with the proviso to this section.
>
> 2. The amount stated above was not included in gross income under paragraph (cA) of the definition of gross income.

3. SARS is of the opinion that the true reason behind the entering of the parties into an agreement of restraint of trade was to compensate the employee for services rendered /to be rendered, and to retain such services of the employee, thus the receipt /accrual meets paragraph(c) of the definition stated above.

4. The amount (R1, 100, 000, 00) accrued during the 2000 tax year."

[14] The appellant raised a further objection to this and in a letter dated 13 October 2004 SARS responded advancing the following reasons for disallowing the objection:

"1. The amount received /accrued by/to you in terms of the restraint of trade entered into with (B), during the 2000 year of assessment of R1, 100, 000, falls in paragraph(c) of the word definition of "gross income" as defined in section 1 of the Income Tax Act, number 58 of 1962, as amended, read with the proviso to this section.

2. SARS is of the opinion that true reason behind the entering of the parties into an agreement of restraint of trade was to compensate the employee for the services rendered/to be rendered, and to retain such services of the employee, thus the receipt/accrual meets paragraph (c) of the definition stated above."

[15] In the Statement of Grounds of Assessment in terms of Rule 10 of the Rule issued in terms of section 107A of the Income Tax Act 58 of 1962, the respondent repeated its reasons for disallowing the appellant's objection namely:

"15.1 The amount received in terms of the restraint of trade agreement falls within the purview of paragraph (c) of the definition of "gross income" as defined in section 1 of the Act.

15.2 The true reason behind the entering of (B) and the appellant into the restraint of trade was to compensate the appellant for services rendered or to be rendered."

15.3 A third alternative was then introduced for the first time, that: "the second tranche of the restraint of trade agreement payment only accrued to the appellant subsequent to the introduction of paragraph (cA) of the definition of "gross income" in section 1 of the Act and the amount should therefore be included in the gross income of the appellant."

In relation to this alternative ground, the respondent's counsel conceded in argument that this ground was not properly before this court.

[16] The issue to be decided by the court is whether the RTA concluded by the appellant and her erstwhile employer was a genuine agreement and the payment in terms of the RTA or any part thereof should be included in the appellant's gross income in respect of the 2000 year of assessment.

[17] The relevant part of the paragraph (c) as definition in section of 1 of the Act includes in gross income:

> "any amount, including any voluntary award, received or accrued in respect of services rendered or to be or any amount (other than an amount referred to in section 8(1) received or accrued in respect of or by virtue of any employment or the holding of any office..."

[18] The essence of the respondent's reasoning is that the payments were made to the appellant as consideration for services rendered or to be rendered and fell to be included in gross income in terms of subparagraph (c) of section 1 of the Income Tax Act No. 58 of 1962.

[19] In advancing this argument the respondent relied on two documents:

> A memorandum dated 10 August 1999 by C to the Remuneration Committee (REMCO) and
>
> An undated document headed: Proposed Restraint payments for consideration and Approval by the Board of directors".

[20] The respondent relied on paragraphs 2, 3, and 5 of the memorandum by C to support its arguments.

[21] In paragraph 2 of the memorandum headed “interest on credit sales” C advised that B had made a commitment to its staff that they would waive the interest payable on the loan advanced to the staff to acquire shares in terms of the B share incentive scheme. The interest payable on the credit sales was seriously eroding the benefits of the share incentive scheme resulting in a disincentive as opposed to an incentive to participating employees.

[22] In paragraph3 of the memorandum headed “Solutions” C advised that the problem could be overcome by simply paying key staff members a restraint payment equal to an amount comprising the interest accrued to date plus the present value of future interest payable.

[23] In paragraph 5 of the memorandum headed “Profit Share and Bonuses” C proposed that the restrain of trade payments be increased in lieu of bonus profit share payments; this would result in the employees receiving such payments tax free and as a quid pro quo the employee would enter into RTA.

[24] In the undated document the management's view was noted that the payment term would be 50% upfront and 50% on future value terms if employed by B after the expiry date of three years. Employees would be obliged to utilize a portion of the restraint payment to acquire shares in B.

[25] According to the respondent the amount received in terms of the "*restrain of trade agreement*" *or* at least part thereof, should be included in the appellant's gross income for the following reasons:

25.1 Part of the payment to the appellant was received prior to the signing of the RTA.

25.2 The true nature of the "*restraint of trade agreement*" was to remunerate the taxpayer for the services rendered.

25.3 In the alternative to paragraph 25.2 above, the restraint of trade payment had a dual purpose, namely to enable the appellant to repay the interest it owed to B in term of the loan that was advanced

to the appellant to enable her to acquire shares in B. The other purpose of the restraint of trade was to restrain the employee for a period of one year after she left the employment of B.

25.4 If the payment had a dual purpose, an apportionment must be applied.

[26] The respondent states that there are a number of facts and circumstances indicating that the payment made to the appellant in terms of the written RTA was remunerate the employee for her services. The effect of respondent's argument was that the RTA was asham and a disguise for compensating the appellant for services rendered.

[27] It is appellant's case that there was no simulated intention, only a real intention by the parties to enter into a valid RTA to which effect must be given. There was no dishonest transaction on the part of B and the taxpayer. The restraint payment therefore did not fall within the purview of paragraph (c) of the definition of gross income.

[28] The critical inquiry in the case before us is the appellant's true intention in entering into the RTA. Has the appellant established on a balance of probabilities, that her true intention was to enter into a genuine RTA as opposed to the alleged disguised and dishonest transaction?

[29] In *Mackay v Fey NO and Another 2006 (3)* SA 182 (SCA) and at 194 G – I, Scott JA, stated the following –

> *"[26] It has long been recognised that, where parties to a transaction for whatever reason attempted to conceal its true nature by giving it some form different from what they really intend, a court called upon to give effect to the transaction will do so in accordance with its substance, not its form, See generally Erf 3138/1 Ladysmith (Pty) Ltd V Commissioner for Inland Revenue 1996 (3) SA 942 (A) at 952C-953A and the cases therein cited. It is important to emphasise that a transaction which is disguised in this way is essentially a dishonest transaction; the object of the disguise, which is common to the parties, is to deceive the outside world. Before a court will hold a transaction to be*

simulated or dishonest in this sense it must therefore be satisfied that there is some unexpressed or tacit understanding between the parties to the agreement which has been deliberately concealed."

And at 195 D –E:

"[28] What is critical to the inquiry, therefore, is appellant's true intention. In other words: was it established on balance of probabilities that his true intention was to enter into a disguised and dishonest transaction in the sense discussed above?"

[30] In ITC *1636* 60 SATC 267 at 301 Kroon J stated as follows-

"In terms of section 82 of the Act, Appellant bore the overall onus of providing the Commissioner's decision to disallow its objection t the assessment was wrong. The agreements in question purport to be genuine sale and leaseback agreements, however, and accordingly, in respect of prima facie case constituted thereby, the Commissioner attached a

burden of rebuttal. This burden not being an onus proper, the Commissioner was not obliged to establish a case on a balance of probability; and if, upon a consideration of all evidence, this court were left in doubt as to whether the Commissioner's decision was right or wrong, then Appellant upon whom the true onus rested, would fail."

[31] In *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A) and at 615G – to 616 A and 620E – G it was held that:

"This was a case in which, as the learned Judge in the court a quo fully appreciated, the overall onus was on the plaintiff to establish that he was the owner of the machinery in question. In our law the possession of a movable creates a presumption of ownership in the possessor (Zandberg v Van ZYl (Supra at 308)) ...But in regard to a subsidiary or intermediate issue within the trial the defendant attracted a burden of adducing evidence in rebuttal – a "weerleggingsls". See South Cape Corporation (Pty)

Ltd V Engineering Management Services (Pty) Ltd 1977 (3) SA 534(A). Since the contract purported to be one in terms whereof, inter alia, Air Capricorn sold the machinery to the plaintiff, the defendant, who asserted that the agreement was really a pledge, had the burden of rebutting the prima facie case of the plaintiff resting on the production of the contract..."

[32] In *Parton and Colam NNO v GM Pfaff (SA) (Pty) Limited* 1980 4 SA 485 (N), at 489F-G it was held that-

"While the onus lay on the respondent to establish that it had ownership as a hire-purchase seller in order to qualify for the relief which was granted, the fact of an agreement signed by the company which was, on the face of it, a hire-purchase contract reserving to the seller rights of ownership prima facie operated to discharge this onus (see the Vasco Dry Cleaners case supra at 616 and the cases referred to therein) and the appellants attracted a burden of adducing evidence in rebuttal (at 615)."

[33] In *Rane Investments Trust v C: SARS* 2003 (6 SA 332 (SCA) (65) SATC 333) and at paragraph 27 it was stated that-

"[27] There is ample authority for the proposition that in seeking t establish the parties' intentions, when a third person is questioning the meaning of a contract, regard may be had to the paries' conduct in executing their obligation. In cases such as Goldinger's Trustee v Whitelaw and Son, Commissioner of Customs and Excise V Randles Bros and Hudson Ltd and Vasco Dry Cleaners v Twycross, this court, in ascertaining the parties' intentions, had regard to subsequent conduct in determining what the parties really intended to achieve. See also Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) where Hefer JA, inndealing with tax avoidance measures, stated that a court will give effect to the true nature and substance of a transaction rather that its form."

Per Lewis JA at 65 SATC 343.

[34] I turn to consider evidence of the appellant in the light of the respondent's contentions.

[35] The appellant testified that when she was approached by C, during August 1999 with the proposal that she should conclude a RTA with that C, she was told that the restraint of would operate for a period of one year after the cessation of her employment and would preclude her from working in *"merchant banking"* for that period. The first offer made to her was too low and was rejected but C revised the offer to the R1, 1million as specified in the RTA and the appellant accepted it. She was at time not aware of other employees to whom similar offers were made and she negotiated only with C.

[36] After her retrenchment the appellant took particular care to ensure that she did not act in breach of the restrain agreement. She testified that she declined offers of employment that would have been in breach of the agreement. She was aware of instances where her erstwhile employer had enforced the restraint against other employees and had no reason to believe that she would be allowed to act in breach of the agreement. Certainly the new controllers of her employer did

not at the time of her retrenchment release her from her obligations under the agreement. She testified that she was satisfied that her employer had given effect to and honoured the agreement in accordance with its terms and that she had done the same.

[37] The appellant further stated that the contents of the memorandum by C were not discussed with her and she had no knowledge of this document. She was offered an RTA on acceptable terms and she agreed to it as a commercial transaction. She was not told what the employer's motives might have been and she could not testify to them.

[38] She stated that in her mind the second offer of R1, 1 million was adequate compensation for not being able to obtain employment for a year. She stated that she did not know the amounts of RTA payments and been determined by management.

[39] Further the appellant testified that she was never a director of B nor a member of the Management Committee

which was responsible for the introduction of the RTA for key management personnel and never has access to any of the minutes of the Board and Executive Committee. She stated that she knew of several disagreements with the employees at B where employees were actively restraint and prevented from breaching the terms of their RTA. She further stated that she believed that the RTA was genuine and she would be held in its terms. There was never a hint to her or ant indication that B did not also regard the agreement as a true and genuine RTA. She stated further that she respected the terms of the RTA and only advised overseas clients on non-restrained areas. In fact her life was profoundly affected by the RTA.

[40] The appellant gave evidence that as far as could recollect she had agreed orally to the restraint prior to the date of the signing of the letter dated 27 October 1999 and the RTA on 29 October 1999. She further stated that on or around 25 August 1999 she had prior discussions with C to be restrained with the proviso that there would be a set-off of certain amount of the restraint payment against the interest owing by her.

[41] The next witness to testify for the Appellant was Mr E (Until Friday 2 June 2006 there were two appeals before court. The respondent conceded the appeal in the E matter on the Friday before the appellant's matter was to be held. The E matter was in every material aspects similar to the appellant's matter).

[42] E testified that he had received a letter from C confirming his willingness to enter into a RTA. The contents of his letter were identical to the contents of the letter received and signed by the appellant. He stated further that he had verbally agreed to the RTA at the end of August 1999. The RTAs that had been entered into with the B were genuine and all the parties regarded themselves bound by its terms and there were examples where employees who had breached the terms of the RTA had been pursued by B and prevented from breaching such terms.

[43] Cwas called as a witness for the respondent, He confirmed the contents of the memorandum dated 10 August 1999, which was drafted by him to the Remuneration Committee (REMCO). He did not recall discussing the issuing of

the memorandum with any employee as it was a management issue. He testified that the RTA was a genuine in every respect and that the parties fully expected the terms to be complied with. He testified that the employee share incentive scheme was not working and instead of proving an incentive was a disincentive staff. He stated that the memorandum was the beginning of the process in an attempt to restrain key personnel and the memorandum in itself was not a product, but a process involving the Board of directors of B (Board) in reaching an objective.

[44] The Board had approved the RTA on the 27th August 1999. He confirmed that it was the policy of B to enforce the RTA and it was in actual fact enforced on a number of occasions. He was aware of the second tranche having been paid, although he was not at B at the time.

[45] He stated that Share Purchase Scheme was a normal scheme and was introduce to incentives and retain key employees and to enable them to build them. The scheme was considered not to be attracted when the share price became

depressed while the loan to fund the purchase of the shares was attracting interest at the rate of 16%.

[46] C stated that the rationale for proposing the RTA was the following: B was faced with a whole host of problems and the overriding objective was to restrain staff because of the problems faced by B. Due to the depressed share price scheme was not serving its purpose and in fact was proving a disincentive. The employees were unhappy. B was faced with real danger of losing its key people who would take valuable knowledge with them. The RTA was used to secure employees and the main objective was to make it difficult for the employees to leave.

[47] He further confirmed that the RTAs were not concluded when taxpayers were employed in 1995 as B was in a totally different position to the one it found itself in 1999. In 1995 B was attractive, sought after employer and key staff could be replaced at that time, relatively easily.

[48] Under cross-examination by Mr Vorster, C confirmed that he discussed with the appellant the terms of her restraint, prior

to 27 October 1999. He emphasised that the Board of B would never have been drafted and entered into agreements which not accurately reflect their true intentions and found offensive, respondent's accusations that the RTAs were shams.

[49] Mr Vorster argued that considering that the respondent's case was that the appellant and her employer had concluded a dishonest transaction one would have expected counsel for the respondent to put to the appellant that she acted dishonestly in concluding the agreement. This was not done. Mr Vorster argued that there was no evidence of conduct inconsistent with the tenor of the RTA. The appellant did not merely produce the agreement, she also testified of her own intention in respect of the RTA and her conduct in relation thereto. Her evidence was unchallenged. Mr Vorster further argued that the unchallenged evidence of the conduct of the appellant's employer in relation to the restraint arrangements with both the appellant and other employees clearly indicated that a genuine restraint was intended.

[50] Mr Louw, counsel for the respondent, argued that the first factor that indicated that the real nature of the transaction

was to remunerate the taxpayer as an employee, was the fact on the appellant's own version R440 000, alternatively R360 000 was paid to her , prior to signature of the RTA. On the appellant's own version she was only restrained from the date of signing the RTA and furthermore that the written RTA contained all terms and conditions of the agreement. Secondly, the memorandum and the undated document that were generated by the appellant's employer, prior to entering into the RTA, indicated that the purpose of the RTA was to remunerate the appellant for her services.

[51] Mr Louw argued further that the RTA was only signed on 29 October 1999 and was therefore only effective from that date. The payment of R440 000, of which R360 000 was applied to set off the interest owed by the appellant, was received on 25 October 1999 as evidenced by disclosure in the appellant's tax return for the 2000 year of assessment, and therefore could not have been received in terms of the RTA.

[52] He submitted that a further fact to be taken into consideration was that B the appellant's employer was in the business of structured finance. As part of the implementing scheme for clients, the tax consequences of a specific transaction was of utmost importance and that if one has

regard to the surrounding circumstances, the real nature of the transaction was to remunerate the employee for her services. Therefore the payment concerned should be included in the appellant's gross income.

[53] In the alternative Mr Louw argued that the payment made to the appellant after the RTA was signed, being R660 000, must be apportioned so as to include 50% of that amount in the taxpayer's gross income.

[54] From the evidence the appellant did not enter into a RTA with the appellant, when she was employed in 1995 but did so only in 1999, for years after she was employed.

[55] The RTA was concluded at the time when the employer considered waiving the interest that was payable by its employees on the loans obtained by them to enable them to purchase shares in B in terms of the share incentive scheme. The waiver of the interest was considered by REMCO and then rejected. However in paragraph 3 of the memorandum to REMCO, C recorded that the problem could be solved by paying

key staff members a restraint payment which they would be obliged to use to reduce their debt.

[56] C, a witness for the respondent, gave evidence which totally consistent with the evidence by E and the appellant. His evidence is that RTA was genuine and that the parties fully expected the terms to be complied with. C testified that the employee share incentive scheme was not working, and instead of proving an incentive, was a disincentive to staff. The memorandum which he authored to the remuneration committee was the beginning of a process in an attempt to restrain key personnel.

[57] C emphasised that it was the policy of B to enthusiastically enforce its RTAs and no evidence was led by Mr Louw to contradict this.

[58] C also confirmed that he had discussed with the appellant the terms of her restraint prior to 27 October 1999. C emphasised that the board of B would never drafted agreements and entered into agreements which did not accurately reflected

their true intentions. His testimony was not any way contradictory to information that he had given to Mr Louw in prior meeting held with him nor was it contradictory to the testimony of E or appellant.

[59 C testified that the share price of B in 1999 was *"underwater"*, making it easier for key staff to be poached and something had to be done, especially in the light of the adverse financial position of B at that time. Restraint of trade agreements were therefore implemented after thinking through all the relevant factors and circumstances. Key persons leaving at that time in B 's history would have made things very difficult, especially replacing them. There was a serious concern that key personnel were dissatisfied with the share incentive scheme, especially the large interest bill which was accumulating and they could be tempted to leave B and take their know-how and proprietary knowledge with them.

[60] There appears to be nothing sinister in our view for the B to have addressed two problems i.e. a concern that key staff could be poached or leave B of their own accord and dissatisfaction with the share scheme which was not

economically viable, with an effective solution. Entering into RTAs with prior agreement that part of the restraint payments would be used to offset an interest bill makes cogent commercial sense. Key staff members were restrained and at the same time were able to settle their interest bills.

[61] In our view, it is inexplicable why the respondent is of the opinion, that an agreement or contemplation by B to pay out restraint of trade payment equal to accrued interest, owing by the restraint employee, prohibits the genuineness of the parties' intentions to enter into a RTA. The appellant gave evidence that she had intimate knowledge which was sensitive to B and valuable to its competitors and B sought to sterilise this information in her possession. The evidence of C and E supported her.

[62] It is well known in commercial circles that executive share incentive schemes prove very effective *"golden handcuffs"*, which not only incentivise executive staff but also bind them t the company. The financial package which has to be offered to executives, to compensate them for leaving a successful share incentive scheme, in an attempt to *"headhunt"* them, is usually

so large as to be prohibitive. However, C testified that there was a need to replace the share scheme which was not working as a *"golden handcuff"* with an RTA. In our view that the erstwhile employer intended this for the appellant is clear from all of the aforegoing. It was commercially understandable and feasible option. The evidence of all witnesses was consistence in this regard.

[63] It does not seem to this court, taking into account the above factors, and in Consideration of evidence led by C who was a witness for the respondent, that the RTA was a genuine agreement. In fact, C in reply to a direct question replied to the effect that he found offensive, any accusation by the respondent that the RTAs were dishonest, simulated or disguise transactions and not in any way genuine.

[64] In our view there is no indication that the parties did not intend to implement the RTA as recorded. The subsequent conduct of the taxpayer, Band E was entirely consistence with their stated intentions as declared in the RTA. As was stated in *Tycon* judgment *(supra)* that, in deciding whether parties into an agreement *bona* or *mala fide,* whether there was any fraud

on their part, whether the agreement was a genuine or simulated one, and what in the final result, was the true substance of the agreement concluded between them, the court will have regard to all the relevant circumstances. This court will look, *inter alia,* to-

64.1 the historical background to the transaction;

64.2 the nature of the negotiations between the parties;

64.3 the purpose for which the parties, respectively, sought to achieve by entering into the transaction;

64.4 the various options available to the parties whereby their purpose could be achieved;

64.5 the terms of the agreement concluded by themselves in light of the surrounding circumstances;

64.6 the manner of implementation thereof;

64.7 the subsequent conduct of the parties;

64.8 the intention of the parties as declared in the agreement or in evidence given by the parties;

64.9 any *indicia* that the parties did not intend to implement the agreement as recorded, or that the agreement did not reflect their true intention.

[65] Evidence given by E, the appellant and C were consistent in that they all gave evidence that RTAs were genuine and that all the parties regarded themselves to be bound by the terms, and that there were examples where employees who had breached their RTA terms, had been pursued by B and prevented from breaching such terms. No evidence was led to contradict this.

[66] The appellant was a truthful and confident witness. There was nothing in her demeanour which suggested that her evidence was in any manner suspect. What one is left with are the suggestions to the appellant in the course of cross-examination that the employer should have entered into the restraint agreement in 1995 when her employment commenced and not inn1999; that her employer was involved in structured finance and that she must have had some knowledge of tax; that her employment agreement in any event contained a confidentiality clause; that it is *"possible"* that the employer

might have applied set-off (of the debt owned by the appellant against the employer's obligation to pay the restraint consideration) before the agreement was signed; that the employer wanted to address problems with regard to the share incentive scheme and that arrangements with regard to the payment of bonuses might have been altered by the RTAs. In the light of C's evidence this court is left in no doubt that B had a genuine RTA in place with its employees.

[67] In our view, in regard to the inconsistency of the dates in respect of the payment, the letter and the date of signature of RTA, E was more forthcoming than the appellant, stating emphatically that by the time payment had been made and a RTA signed, an oral binding contract had been entered into between B and himself, on the terms of the RTA. In answer to a question by Mr Vorster, counsel for the appellant, E replied that he had previously advised Mr Louw that an oral agreement had been reached with B, sometime in August 1999.

[68] The respondent has brought a case before the court based on inferences and implications and was not able to contradict the evidence of the appellant. C and E.

[69] The respondent fro the first time submitted at this hearing an alternative argument fro the apportionment of the second tranche of R660, 000. The respondent submitted that 50% thereof should be for services rendered and therefore the amount of R330, 000 should be included in the taxpayer gross income. According to the respondent the *quid pro quo* that the taxpayer gave was to render services and to honour the restraint agreement and that it was equitable to apportion the amount in these circumstances on a 50/50 basis.

[70] Mr Vorster argued that in terms of Rule 10(3) the statement of the grounds of assessment must set out the grounds upon which the taxpayer's objection was disallowed. He argued that the appellant was not brought to court by the respondent on the basis of the alternative appointment argument, but on what was contained in the statement of the grounds of assessment which were based on allegations of dishonest against the taxpayer. Vorster argued that if Louw wished to argue apportionment then he should have stated that the grounds for the disallowance of the objection. In our view the issue before the court was defined by the Commissioner in

his grounds of assessment and alternative ground of an appointment was not raised until now. It would be inequitable for this court to deal with this ground at this stage when the taxpayer has not been informed of this in the statement of the grounds of assessment.

[71] In our view the appellant has established on a balance of probabilities her true intention to enter into a genuine RTA. The appellant has discharged the onus of proving the dispute assessment to be incorrect and in our view the appellant is entitled to an order allowing the appeal and setting aside the revised assessment issued in respect of her 2000 tax year.

[72] The appellant seeks an order that the costs of this appeal should be paid by the respondent.

[73] In a letter dated 24 May 2006 the respondent was advised by the appellant's representatives that an order for costs would be sought on the scale applicable between attorney and client.

[74] The costs order is sought in terms of section 83(17) (a)of the Act which empowers the Tax Court to grant an order for costs in favour of an aggrieved party *"where the claim of the Commissioner is held to be unreasonable"*.

[75] In our view the introduction at this late stage of the alternative argument on the apportionment was tantamount to yet another unjust and unreasonable action on the part of the respondent, bordering on harassment of the taxpayer.

[76] There has been no explanation of the respondent's whimsical conduct in relation to the grounds of assessment. When the appellant was assessed for the year 2000 on 28 February 2001, the first tranche was not included in her gross income. This was also the case with the revised additional assessment fro the same tax year dated 11 July 2001. On 18 December 2003, SARS issued the dispute assessment and included the full restraint of trade payment of R1, 1million in gross income. On 30 January 2004 the appellant requested the respondent to furnish full reasons for the dispute assessment and SARS responded on 13 July 2004 with the same reasons furnished in their letter dated 22 December 2003. The appellant

requested reasons in terms of the PAJA Act in July 2004 and SARS responded on 2 September 2004. In response to the appellant's letter dated 13 October 2004 objection to the disputed assessment SARS simply repeated the contents of their letter dated 2 September 2004.

[77] The grounds that SARS relied on for the disallowance of the objection in the statement that SARS issued in terms of Rule 10 was that:

> "The amount received by the appellant in terms of the restraint of trade agreement falls within the purview of paragraph (c) of the definition of "gross income" as defined in section 1 of the Act
>
> Alternatively,

The amount payable in terms of the restraint was conditional upon the Appellant being employed by (B) when the second tranche became payable. Consequently the second tranch received by the appellant only accrued to her after 23 February 2000. Therefore, paragraph (cA) of the definition of "gross income" in section 1 of the Act is applicable and the amount of R660, 000 should be in the taxpayer's gross income."

[78] This alternative ground raised as far back as December 2005 was abandoned by the respondent in argument during these proceedings.

[79] However the alternative argument on the apportionment was raised for the first time during these court proceedings. The taxpayer could not have been prepared for this challenge at this late stage and in our view has insufficient time to defend this ground.

[80] The power of the Tax Court to award costs on the attorney and client scale was recently considered by Southwood J in *ITC 1806*68 SATC117. After considering the history of the section the learned judge said the following in paragraph [8] of the judgment-

> *"Subsection 83(17) is radically different from its predecessors. Such a change indicates a radical change of intention. Instead of a prohibition on making cost order the court now has a discretion to make costs orders in each of the five situations. The discretion is not limited in any way.*

There is no justification for reading into the subsection a qualification that a costs order maybe made against the respondent only if it is established that he acted unreasonably. There is also no justification for limiting the meaning of the word 'costs' to party and party costs. The legislature is presumed to know that courts may make costs order on the scale as between attorney and client. By expressly conferring on the tax court the power to make costs orders it is a necessary implication that these orders may be on the well-known and recognised scales used by the High Court, the magistrates' courts and other courts".

[81] This proposition is, with respect, correct and should be adopted by this court.

[82] In considering whether an order for costs on the punitive scale should be made, Southwood J at [37] of his judgment referred to the following statement in *In Re Alluvial Creek Ltd* 1929 CPD 532 at 535

"An order is asked for that he pay the costs as between attorney and client. Now sometimes such an order is given

because of something in the conduct of a party which the Court and things like that, but I think the order may also be granted without any reflection upon the party where the proceedings are vexatious I mean where they have the effect of being vexatious, although the intent may not have been that they should be vexatious. There are people who enter into litigation with the most upright purpose and a most firm belief in the justice of their cause, and yet whose proceedings may be regarded as vexatious when they put the other side to unnecessary trouble and expense which the other side ought not to bear".

[83] He painted out that this statement was approved by the Supreme Court of Appeal in JHB *City Council v Television and Electrical Distributors (Proprietary) Limited and Another* 1997 (1) SA 157 at 177D-E subject to the following rider:

"Naturally one must guard against censuring a party by was of a special costs order when with the benefit of hindsight a course of action taken by a litigant turns out to be a lost cause".

[84] After examining the conduct of the respondent's officials in that case, in which the Tax Appeal Committee also featured, Southwood J concluded that the respondent's conduct vas vexatious and awarded costs on the scale applicable as between attorney and client.

[85] The respondent was at all time aware that there was no relevant difference between the case of the appellant and that of E. In issuing the disputed assessment in this and the E appeal which was conceded on the Friday afternoon 2 June 2006, the respondent held the view that the RTA was a simulated or disguised transaction and that the true reason behind entering into RTA was to compensate the appellant for services rendered or to be rendered and retain such services of the employee. The reason given by the respondent for the disallowance of the appellant's objection to the disputed assessment is identical to the reason given for the allowance of the objection in the E appeal.

[86] The respondent was aware that they were colleagues employed by the same employer and that they had signed restraint agreement in identical terms, more or less

contemporaneously and under identical circumstances. Indeed, as is evident from the respondent's notice of intention to amend its Rule 10 statement in the E appeal and from Rule 10 statement filed in the appeal of the appellant, he is relying on the very same documents in both appeals to support the previously abandoned allegations of simulation. In the light of the concessions contemporaneously made in relation to the E appeal, the respondent's conduct in relation to the appellant is clearly in our view unreasonable, frivolous and vexatious.

[87] Both E and the appellant were put to the expense of a trial in order to defend themselves against the respondent's allegations of impropriety. At the very last minute, the E appeal was conceded by the respondent without any explanation. In the course of the hearing of the of the appellant's appeal not a shred of evidence of impropriety on the part of the appellant emerged and it was not even put to her during cross-examination that she participated in a dishonest transaction. Moreover, her evidence is supported by the respondent's own witness, C. The respondent consulted with E, days before the hearing commence and the respondent's officials and counsel well knew that the respondent's allegations against the

appellant would not be supported by the respondent's witness. Nonetheless it persisted in putting the appellant to the expense of an appeal with an outcome predictably adverse to the respondent. Such conduct in our view constitutes the harassment of a taxpayer and does not behove the respondent.

[88] In our view having considered all of the a foregoing, the conduct of the respondent in this case is far worse that the conduct considered by Southwood J in *ITC 1806 (Supra).* The respondent has acted unreasonably in pursuing tax of approximately R400, 000 when its case was tenuous if not weak and subjected the appellant taxpayer to enormous costs. In this case, the respondent's conduct displays an arrogant disregard for the rights of the appellant to administrative action that is reasonable and procedurally fair. The respondent's claim in the form and circumstances now before this Court, is patently unreasonable within the meaning of section 83 (17) (a) of the Act and it is proper in our view for the court to grant an order for costs in favour the appellant on the scale applicable between attorney and client.

K[89] In the result, the following order is made:

89.1 The appeal is allowed and the assessment is aside.

89.2 Costs are awarded in favour of the appellant on the sale applicable between attorney and client.

H SALDUKER-PRESIDENT

ON BEHALF

MR ERNIE LAI KING (COMMERCIAL MEMBER)

MR YOUNAID WAJA (ACCOUNTANT MEMBER)