IN THE TAX COURT OF SOUTH AFRICA

CASE NO: 12236

In the matter between:

D LIMITED Appellant

and

THE COMMISSIONER FOR THE

SOUTH AFRICAN REVENUE SERVICE Respondent

JUDGMENT

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1. This is an appeal by the appellant, D Ltd, against a decision of the respondent, the Commissioner for the South African Revenue Service ("the Commissioner") disallowing an objection against a secondary tax on companies ("STC") assessment.

2. On 24 April 2006 the Commissioner issued an assessment relating to the appellant's dividend cycle of 16 May 2004 to 27 January 2005 in which he levied STC of R28 332 885,50 on a dividend amount of R226 883 084,00. The appellant objected against the assessment on 12 May 2006. On 14 August 2006 the Commissioner disallowed the objection. On 14 September 2006 the appellant filed a notice of appeal

contending that it was not liable for any STC in respect of the relevant distribution.

3. Most of the relevant facts are common cause or are at least not disputed by the Commissioner. These are set out in a statement of agreed facts, and were supplemented by the testimony of Mr BD and Mr AB who testified on behalf of the appellant.

4. Prior to 27 January 2005, the appellant was the holding company of a number of subsidiaries of which D A Ltd ("DA") was the main operating company. The other subsidiaries consisted of an intellectual property holding company, two property companies, subsidiaries in Botswana and Namibia, and two dormant companies. The shares held by the appellant in the subsidiaries were acquired and held as investments.

5. On 18 November 2004, the shareholders of the appellant resolved to dispose of its assets. The resolution reads:

> "Resolved that the Company, pursuant to and in terms of section 228 of the Companies Act 1973, as amended, sell and dispose of all its assets other than its shares in dormant subsidiaries and DA Ltd to C (Proprietary) Limited for a purchase consideration payable to DA Limited) of R550 298 138."

6. The shares in the appellant, according to Mr AB who testified on behalf of the appellant, were held by "EP Equity" (75%) and management

(25%). The exact nature of the entities holding the shares is not clear from the evidence, but is in any event not relevant.

7. The objective of the resolution was to dispose of all of the appellant's assets in the D group of companies. This was ultimately effected by a single "indivisible" transaction in which the appellant sold the business of DA as a going concern as well as its shares in the other subsidiaries (except those in the dormant companies) to C for the stipulated purchase consideration. The effective date of the sale agreement was 27 January 2005.

8. On the same day, pursuant to a resolution of its shareholders taken on 25 January 2005, DA distributed an amount of R426 152 780,10 to the appellant. The shareholders resolution of 25 January 2005 resolved to distribute an amount of R343 811 457. This amount was made up of a return of share premium in the amount of R68 811 457, a dividend of R206 080 509,90 (exempt from STC in the hands of DA), and R68 919 490,10 in revenue profits. The balance of R82 341 323,10 was applied to the repayment of the loan account.

9. In terms of a resolution of the shareholders of the appellant passed on 25 January 2005 it was resolved to approve a distribution of R498 million from the appellant to its shareholders to be paid on 27 February 2005. The issue for determination is the amount of STC payable with respect to this payment.

10. The relevant provisions of the governing section of the Income Tax Act 58 of 1962 ("the Act"), section 64B, in the terms applicable at the time of the distribution, were as follows:

"(2) There shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the secondary tax on companies, which is calculated at the rate of 12,5 per cent of the net amount as determined in terms of subsection (3), of any dividend declared on or after 14 March 1996 by any company which is resident.

(3) Subject to subsection (3A) the net amount of any dividend referred to in subsection (2) shall be the amount by which such dividend declared by a company exceeds the sum of any dividends which have accrued to that company during the dividend cycle in relation to such firstmentioned dividend: Provided that -

(a) where the sum of such dividends accrued exceeds such dividend declared, the excess shall be carried forward and be deemed to be a dividend which accrued to the company during the succeeding dividend cycle of the company; and

(b) in the determination of the net amount of any dividend distributed in the course or in anticipation of the liquidation or winding up or deregistration of a company, there shall be allowed as a deduction any dividend contemplated in subsection (5)(c) which has during the current or any previous dividend cycle *accrued* to the company

(3A) In determining the sum of the dividends which have accrued to a company as contemplated in subsection (3), no regard must be had to -

(a) any dividend contemplated in subsection (5)(b),(c) or (f) ....

(5) There shall be exempt from the secondary tax on companies - …….

(c) so much of any dividend distributed in the course or in anticipation of the liquidation or winding up or deregistration of a company, as is shown by the company to be a -

(i) distribution of profits derived during any years of assessment which ended not later than 31 March 1993, (other than any such profits derived by way of the revaluation of trading stock held by such company); or

(ii) distribution of profits of a capital nature (other than capital profits attributable to the disposal of any asset on or after 1 October 2001 which capital profits must, in the case of an asset acquired before that date, be limited to the amount of profit determined as if that asset had been acquired on 1 October 2001 for a cost equal to the market value of that asset on that date determined in the manner contemplated in paragraph 29 of the Eight Schedule): ……

Provided that where such dividend is distributed in anticipation of the liquidation or winding up or deregistration of a company and such company -

(i) has not within six months taken such steps as contemplated in section 41(4) to liquidate, wind up or deregister that company; or

(ii) has at any stage withdrawn any step taken to liquidate, wind up or deregister that company, as contemplated in paragraph (i), or does

> anything to invalidate any such step so taken, with the result that the company is or will not be liquidated, wound up or deregistered

> the provisions of this paragraph and of subsection (3)(b) shall be deemed not to have applied to such dividend and any secondary tax on companies which becomes payable as a result thereof shall be recoverable from the shareholders to whom such dividend was distributed in the same proportion as such dividend was so distributed."

11. With effect from 8 November 2005 (that is 11 months after the distributions in this case) sections 64B(3) and 64B(3A)(a) were amended to reformulate the legislative treatment of accrued dividends exempt from STC (in the hands of the declaring subsidiary) in determining the net amount of STC payable by the declaring holding company. Subsection (3) in so far as it is relevant, now reads:

> "(3)Subject to subsection (3A), the net amount of any dividend referred to in subsection (2) is the amount by which the dividend declared by a company exceeds the sum of any dividends (*other than any dividends contemplated in subsection (5)(c)*) which have accrued to that company during the dividend cycle in relation to that first-mentioned dividend: ….."

Section 64B(3A)(a) has been consequentially amended to delete any reference to subsection (5)(c).

12. This amendment does not have a substantive consequence. The treatment of dividends accrued to a holding company that have benefited from a subsection (5)(c) exemption in the subsidiary remains

the same. The legislature appears to have intended merely to clarify the formula by providing upfront that exempt liquidation dividends not be included in the accrued dividends to be deducted from the declared dividend for the purpose of determining the net amount.

13. In its return for payment of STC for the dividend cycle 16 May 2004 - 27 January 2005 the appellant computed its STC liability to be nil. The Commissioner on the other hand calculated an amount of R28 811 074,37 to be the STC payable. Before turning to the respective calculations it should be mentioned that the parties are in agreement that no STC was payable by DA in respect of its distribution to the appellant. It will be recalled that the Appliance's distribution was made up as follows:

Repayment of loan account:	82 341 323,10
Reduction of share premium:	68 811 457,00
Distribution of capital profits (exempt from STC i.t.o. section 64B(5)(c)	206 080 509,90
Distibution of revenue profits (exempt from STC i.t.o. section 64B(5)(f)	68 919 490,10
	R426 152 780,10

14. With regard to the R498 million distribution by the appellant to its shareholders (the distribution in issue), it is not in dispute that the amounts received as capital profits arising from the sale of the shares in the subsidiaries other than DA qualified for partial exemption. Thus the distribution to the appellant's shareholders included an amount

comprising the capital profits from such sales relating to the period before 1 October 2001. Hence the receipts were exempt to that extent in terms of section 64B(5)(c)(ii) on account of being profits of a capital nature making up part of the dividend declared in the course of or in anticipation of the liquidation of the appellant. I pause here to interpose that there is no dispute that the appellant proposed to terminate its corporate existence, though there was a somewhat muted challenge to whether there had been compliance with the formal requirements of the proviso to subsection (5)(c) and a debate about its stage of liquidation relevant to whether the profits realised were of a capital nature. We are satisfied that the formal requirements have been met and no more need be said in that regard. I will return to the issue regarding the stage of liquidation later. The Commissioner has calculated the amount of the exempt liquidation dividend in respect of the sale of the shares in the subsidiaries to be R61 430 895, while the appellant calculated it to be the lesser amount of R59 824 897. The appellant has submitted (without any challenge from the Commissioner) that the Commissioner’s calculation should be regarded as the correct amount for the purposes of the appeal.

15. The original cost of the appellant’s shares in DA, it is common cause, was R28 451 459.

16. The manner in which the appellant arrived at its calculation of a nil liability for STC in respect of the distribution to its shareholders is set out in paragraphs 4.16 and 5.4 of its Rule 11 Statement of Grounds of

Appeal. It claims that an amount of R365 136 438,00 is exempt. It arrived at that figure as follows: R275 million was received from DA as a distribution of profits (R206 080 509,90 as capital profits and R68 919 490,10 as revenue profits). To that amount the appellant added R68 811 457,00 being the amount it received as a reduction of share premium. This gave a figure of R343 811 457,00 from which it deducted the original cost of the shares, leaving R315 359 998,00 from which it further deducted R10 048 457,00 being the post 1 October 2001 capital profits not regarded as exempt in terms of section 64B(5)(c)(ii). This left an amount of R305 311 541,00 to which it added its calculation of the exempt amount in respect of the disposal of the shares in the other subsidiaries, namely R59 824 897,00. The appellant's calculation of the exempt position of the R498 million distribution to its shareholders can accordingly be depicted as follows:

R275 000 000 (capital and revenue profits from DA)

68 811 457 (reduction of share premium)

R343 811 457

- 28 451 459 (less original cost of shares)

R315 359 998

- 10 048 457 (capital profits after 1 October 2001)

R305 311 541

59 824 897 (capital profits from sale of shares)

R365 136 438

17. From the evidence and submissions made during argument it is evident that the appellant accepted that the formula for determining STC liability from a reading of section 64B as a whole might be expressed as follows:

"(Declared Dividend - Exempt: section 64B(5))

minus (Accrued Dividends - Excluded Dividends: section 64B(3) and (3A))

= Amount

less (Deduction provisio to section 64B(3)(b)).

= Net Amount

x12,5%

=STC payable

(DD - E) - (AD - ExD) - Deduction = Net Amount"

18. The appellant's calculation was thus:

DD - E

(498 000 000 - 365 136 438) = 132 863 562

AD - ExD

(275 million - 275 million) = Nil

Deduction proviso section 64B(3)(b) = 206 080 509

206 080 509

Therefore: 132 863 562 - Nil - 206 080 509 = Nil

19. It is important to note that of the R275 million distributed to the appellant by DA (being the amount other than the repayment of the loan and share premium) R206 080 509,90 was exempt under subsection 5(c) as being profits of a capital nature, while the balance of R68 919 490, 10 was exempt under subsection 5(f). Section 64B(5)(f) exempts from STC any dividend declared by a controlled group company which accrues to a shareholder under certain circumstances. It is common cause that DA qualified for the exemption with the result that the entire R275 million dividend fell within the exclusion contemplated in section 64B(3A)(a) prior to its amendment.

20. It is fair to surmise that the unbundling scheme and sale to C (Pty) Ltd was structured to achieve this desired tax result. Neither the appellant nor DA incurred any liability for STC, at least according to the appellant. The sale agreement was concluded on 22 November 2004 subject to certain conditions. Those conditions were fulfilled on 25 January 2005, on which day the shareholders and directors of both the appellant and DA took the necessary resolutions effecting the distributions. On the same day resolutions were taken to liquidate the appellant and DA. On 27 January 2005 the sale was effectuated, the

distributions made and Appliance's name changed to Di Ltd. The resolutions for winding up were lodged on 12 July 2005 and registered with the Registrar of Companies on 20 July 2005.

21. In March 2005 the appellant submitted the IT 56 form, being its return for payment of secondary tax on companies for the relevant dividend cycle. In a letter dated 19 May 2005 the South African Revenue Service ("SARS") took issue with the appellant's calculation of STC for the first time. This commenced a process of discussion, negotiation and correspondence in which various issues and calculations were canvassed and which ultimately has resulted in the present appeal. It is unnecessary to examine the various stances taken in any detail as it is best to rely on the grounds of assessment, the objection and appeal statements. However, it is noteworthy that from the outset SARS took the view that the distribution from DA to SARS was not a profit of a capital nature, because the appellant had not sold its shares in DA to C (Pty) Ltd, and secondly it objected to the appellant seeking to claim two exemptions in respect of the same profits. The view was clearly expressed in the letter of 19 May 2005 that DA was entitled to an exemption under section 64B(5)(c) in respect of the capital profits (R206 080 509,90) but the appellant was restricted to a deduction (referred to as an exemption by the writer) under section 64B(3). We assume the writer had paragraph (b) of the proviso to section 64B(3) in mind. The point was made again in a letter from SARS dated 22 February 2006, as follows:

> "Furthermore, your treatment cannot be correct as the following has taken place: D (appellant) in calculating its section 64B(5)(c) exemption has included the profit made on the sale of the business of DA, and has also claimed the section 64B(3) exemption which relates to the capital profits made by DA. You will notice then that D has claimed two exemptions against the same profits; which in my opinion is incorrect."

22. On the basis of its view that none of the distributions by DA to the appellant (the repayment of the loan, the reduction of share premium or the R275 million distribution of capital and revenue profits) were profits of a capital nature as contemplated in section 64B(5)(c)(ii) and thus exempt from STC as a declared dividend to the shareholders of the appellant, SARS calculated the appellant's STC liability as follows:

Dividend declared:	R498 000 000
Less: Exempt proceeds sale of shares in subsidiaries	61 430 895
Dividend subject to STC	R436 569 105
Less: deduction i.t.o. proviso to section 64B(3)(b) in respect of Appliance's exempt capital profits	R206 080 510
Net Amount	R230 488 595
STC at 12,5%	R28 811 074,37

23. The essential objection to the assessment is that the amount received from DA is exempt from STC in terms of section 64B(5)(c) as constituting a profit of a capital nature. The appellant contends that it did not receive the dividend of R275 million in the ordinary course. It

arose solely due to the fact that the appellant, in its capacity as the sole shareholder of DA, had resolved to liquidate the company and a decision had been made by the appellant and directors that, in anticipation of the liquidation of DA, this amount be paid to the appellant. Given that the appellant had always held its investment in DA as a capital asset, this amount of R275 million constituted a receipt of a capital nature in the appellant's hands. Similarly, it argued, the reduction in share premium of R68 811 457 distributed by DA to the appellant in anticipation of liquidation also constituted a receipt of a capital nature in the appellant's hands, from which had to be deducted the original cost of the investment of R28 451 459 and the capital profits post 1 October 2001 of R10 048 457. The issue then is simply whether the balance of R305 311 541 received from DA ("the disputed amount") should be regarded as exempt from STC in terms of section 64B(5)(c).

24. The Commissioner appears to take the view that before the exemption in terms of section 64B(5)(c) can apply it is required that there be a disposal of a capital asset. Some support for such an interpretation can be found in the reference to "the disposal of any asset" in section 64B(5)(c)(ii). The appellant did not dispose of its shares in DA to C (Pty) Ltd. DA instead sold its business to C. I agree with Mr Bhana, counsel for the appellant, that the reference to a disposal of an asset in the portion of the provision in parenthesis is only relevant to the description of those profits excluded from the exemption. The portion in parenthesis is a qualification as to the manner in which capital profits

are calculated *if* there is a disposal of an asset. Where there is no disposal of an asset there is no limitation on the amount of the exemption. Limited as it is to the issue of calculation, the qualification in parenthesis sets no requirement that a distribution be consequent upon the disposal of an asset before it can assume the character of "a distribution of profits of a capital nature".

25. That being the case, the only requirements to qualify for the general exemption, according to the appellant, are that the disputed amount must have been a distribution of profits of a capital nature and should have been declared in the course or in anticipation of the liquidation, winding up, deregistration or final termination of the corporate existence of the appellant.

26. Regard being had to the various resolutions there can be little dispute that the disputed amount was distributed in anticipation of the liquidation of the appellant. Such is in any event common cause as reflected in paragraph 2.12 of the statement of agreed facts.

27. In consequence, the focus of both parties during argument was upon whether the disputed amount was a profit of a capital nature.

28. The Commissioner submitted at the outset that the fact that most of the disputed amount was capital in the hands of DA did not mean it was capital in the hands of the appellant and the nature of the receipt must be separately evaluated for each taxpayer. That must be so.

29. The essence of the Commissioner's argument is that the disputed amount did not constitute a return of share capital or capital employed. Rather, he maintains, it is a return on capital, the fruits of capital, irrespective of the intention regarding the overall unbundling scheme. Moreover, the intention in declaring the dividend was in part to provide the management shareholders with cash to buy shares in C (Pty) Ltd.

30. The Commissioner's argument is too formalistic. The shares held by the appellant in the subsidiaries were capital assets. The reason the appellant sold DA as a going concern rather than selling the shares to C (Pty) Ltd was because it could obtain a better price. There were obviously commercial advantages to C (Pty) Ltd obtaining the business of DA in this way. Pursuant to the transaction, the value of the shares in DA lost all their value because there was in effect a disposal of the assets underpinning the value of the shares.

31. The cardinal principle applicable in determining the capital or revenue nature of a distribution for the purposes of section 64B(5)(c)(ii) should be no different than that enunciated in *Elandsheuwel Farming (Edms) Bpk v SBI* 1978 (1) SA 101 (A), at 118A where Corbett JA said:

> "Where a taxpayer sells property, the question as to whether the profits derived from the sale are taxable in his hands by reason of the proceeds constituting gross income or are not subject to tax because the proceeds constitute receipts or accruals of a capital nature, turns on the further enquiry as to whether the sale

> amounted to a realisation of a capital asset or whether it was the sale of an asset in the course of carrying on a business or in pursuance of a profit-making scheme. Where a single transaction is involved it is usually more appropriate to limit the enquiry to the simple alternative of a capital realisation or a profit-making scheme. In its normal and most straightforward form, the latter connotes the acquisition of an asset for the purpose of reselling it at a profit. The profit is then the result of the productive turnover of the capital represented by the asset and consequently falls into the category of income. The asset constitutes in effect the taxpayers stock-in-trade or floating capital. In contrast to this the sale of an asset acquired with a view to holding it either in a non-productive state or to derive income from the productive use thereof, and in fact so held, constitutes a realisation of fixed capital and the proceeds an accrual of a capital nature. In the determination of the question into which of these two clauses a particular transaction falls, the intention of the taxpayer, both at the time of acquiring the asset and at the time of its sale, is of great, and sometimes decisive, importance."

32. At the time the appellant invested in DA it undoubtedly acquired the shares with the intention to acquire a productive asset from which to derive an income. Dividends received by the appellant prior to the sale of Appliance's business and during the ordinary course of business would have been of a revenue nature and involved no realization of fixed capital. However, the dividend received by the appellant consequent upon the sale of the business to C (Pty) Ltd was unusual or extraordinary in nature and was in consideration for the denuding of the value of the shares in DA. The shareholder in DA (the appellant) would not have authorised the sale and distribution with the corresponding decline in the share value without the intention of realising the fixed capital. The disputed amount was an extraordinary

dividend arising on the realisation of the fixed capital in DA as an integral part of the appellant's decision to realise all its interests in all its subsidiaries. The sale agreement was an indivisible hybrid transaction involving the sale of shares in the other subsidiaries and the sale of Appliance's business. The appellant realised the value in the shares by selling the business as a going concern. As such, the profits derived from the realisation of that value were profits of a capital nature.

33. The puzzling suggestion in some of the correspondence that a dividend is always of a revenue nature cannot be sustained. The very existence and *raison d'etre* of section 64B(5)(c)(ii) puts beyond debate the possibility of a dividend distributing capital profits. A dividend is not limited in the Act to a distribution of revenue or trading profits. The distinction is ascertained, as I have said, by having regard to the intention of the shareholders in acquiring, holding and ultimately realising the value in the shares.

34. We also accept the appellant's submission that a dividend declared in anticipation of liquidation would constitute a distribution in liquidation. In *New Mines Limited v CIR* 1938 AD 455 it was held that post liquidation distributions of profits are not income but will always be of a capital nature for the purposes of income tax. Thus if the Appliance's distribution was a distribution in liquidation the distribution was of a capital nature in the appellant's hands. The Commissioner submitted

that a liquidation distribution can only occur once the liquidation is formally underway.

35. In *ITC101* 3 SATC 324, the court stated the following in relation to a contention that a distribution which had been made by a company in anticipation of its liquidation was of a capital nature in the hands of a shareholder (at 325):

> "…the point to be decided was whether, in the light of the facts the distribution … was or was not a distribution in liquidation. If it was a distribution in liquidation it represented in the hands of the recipient an enhancement of capital and was not taxable, but if it was a distribution other than in process of liquidation it was a distribution of profits and as such was subject to supertax …"

The court found that the relevant distribution was not a distribution in liquidation on the ground that neither the distributing company nor its board had formally expressed an intention to liquidate or taken any steps to carry such intention into effect. By contrast, in the present matter DA formally expressed its intention to liquidate in the resolutions passed simultaneously with the decision to make the distribution to the appellant. It also took steps to carry its intention to liquidate into effect. It is also common cause that the distribution in this case was in anticipation of liquidation. We are accordingly satisfied that the distribution from DA was a dividend in liquidation. Moreover, it would be artificial and arbitrary to consider the distribution to be of a revenue nature simply because it was declared "in anticipation of" as opposed to "in the course of" the liquidation.

36. Proceeding on this basis then, the total liquidation dividend including the distribution of revenue profits and the reduction of share premium would constitute a distribution in liquidation. The total amount in that case would be R343 811 457 (R275 000 000 + R68 811 457). From that the appellant deducts the original cost of the shares, R28 451 459, leaving an amount of R315 359 998. However, although there has not been a disposal of an asset (in the form of the Appliance shares) the appellant accepts that there was in substance a disposal of the shares by realising the underlying value, and, therefore, the extent of the exempt capital profits is limited to those capital profits attributable to the period before 1 October 2001 and hence a further R10 048 457 must be deducted, leaving the disputed amount of R305 311 541.

37. While it may be acceptable, in the light of the common law, for income tax purposes to regard both the capital and revenue profits distributed by DA to the appellant (R206 080 509,90 and R68 919 490,10 = R275 000 000) as distributions in liquidation, and thus capital in nature, the same cannot be said of the reduction in the share premium for STC purposes. It must be kept in mind that STC is a tax on dividends declared. A dividend is defined in section 1 of the Act to mean any amount distributed by a company to its shareholders but the definition is further circumscribed by a plethora of inclusions and exclusions. Paragraph (c) of the definition includes in the "amount distributed" in the event of any reduction or redemption of the capital of a company so much of any cash or value given to the shareholder as exceeds the

cash equivalent of the nominal value of the shares. Thus, at first blush, a reduction of share premium does constitute a dividend. However, in terms of paragraph (f) of the definition the “amount distributed” does not include cash or assets representing a reduction of the share premium account of a company. The rationale behind the inclusion and exclusion is not immediately evident. If the share premium account includes “tainted” capitalised reserves, and there is a repayment of share premium, paragraph (f) is overridden by paragraph (i) read with paragraph (iii) of the first proviso of the definition. These provisions ensure that any reduction in the share premium account is treated as a dividend to the extent of the capitalised reserves. Accordingly, a return by a company of its share premium to its shareholders is a dividend only to the extent of any profits that were previously transferred to the share premium account.

38. It is common cause that the share premium returned as part of the distribution by DA to the appellant was untainted by capitalised reserves or revenue profits. Accordingly, despite such being considered a distribution in liquidation at common law, in accordance with the Act that part of the distribution is not part of the dividend for STC purposes. The effect of this is that such distribution does not attract STC in the hands of the declaring company (DA) and does not qualify as an accrued incoming dividend in the hands of the appellant. It does not follow that the ongoing distribution of the share premiums to the appellant’s shareholders is not a dividend. It is; because the ongoing distribution to them does not involve any share premium

reduction. It accordingly forms part of the dividend declared by the appellant but is not an accrued incoming dividend for the purpose of determining the net amount. On the assumption also that a return of share premium is not a "profit" or enhancement of fixed capital it would seem not to qualify as exempt for STC purposes in terms of section 64B(5)(c)(ii) either. The exemption in section 64B(5)(c)(ii) extends to so much of any dividend shown to be a distribution of *profits* of a capital nature. Capital though untainted share premium may be, the return of it is not a dividend of capital profits and hence the distribution is not exempt. On this analysis only the distribution of the capital and revenue profits of R275 000 000 from DA to the appellant would fall into the category of capital profits.

39. But the matter does not end there. In its correspondence SARS emphasised that the interpretation sought by the appellant resulted in the R275 million having the benefit of exemption twice. In the correspondence, the grounds of assessment and the computation of the liability, the Commissioner evinced an approach to the STC formula limiting the appellant to a deduction in terms of paragraph (b) of the proviso to section 64B(3), which is restricted to the amount of the exemption of the profits of a capital nature enjoyed by the subsidiary.

40. It will be remembered that R206 080 509,10 of the R275 million distributed as a dividend to the appellant by DA was exempt from STC in the hands of DA in terms of section 64B(5)(c)(ii) and the balance of R68 919 490,10 was exempt in terms of section 64B(5)(f).

41. The problem of double favourable treatment was not adequately canvassed by counsel for the Commissioner during argument, even though we invited submissions on the question. To us the matter is of critical importance. It strikes us that the provisions of section 64B read contextually and purposively as a whole disclose a policy consistent with the Commissioner's submission that double favourable tax treatment of the same amount is intended only to the limited extent of a deduction, as opposed to a second exemption, whenever the holding company that has received an exempt liquidation dividend in turn chooses to go into liquidation. Counsel for the appellant has argued that the Commissioner did not formally plead the point. We disagree. It is evident from the correspondence and the pleadings that the Commissioner has always taken the view that only a deduction under paragraph (b) to the proviso is permitted.

42. The basic formula contained in section 64B is that STC is payable on the net amount of the declared dividend, being the declared amount less the incoming dividends that have accrued - section 64B(3). The reason for exempting the accrued dividends under section 64B(3) is that they would have already been subject to STC in the subsidiary distributing them to the declaring company. The aim is to avoid double taxation. Consistent with that aim, certain incoming dividends that have had the benefit of an exemption in the subsidiary are *excluded* by section 64B(3A)(a) when determining the sum of the incoming accrued dividends, namely any dividend contemplated in subsections (5)(b), (c)

or (f). As explained earlier, since the most recent amendment to the Act, the exclusion of a dividend exempt under subsection (5)(c) is now accomplished by a parenthetic exclusion in the body of section 64B(3). By virtue of their prior favourable tax treatment in the subsidiary, incoming accrued exempt dividends, unlike other incoming non-exempt dividends, are in no danger of double taxation.

43. The policy is evident from the interplay and relationship between section 64B(3), section 64B(3A)(a) and paragraph (b) of the proviso to section 64B(3); read with section 64B(5)(c). As a general rule the formula is: (declared dividends - exempt) - (accrued - excluded) = net amount. However, section 64B(3A)(a) read with paragraph (b) of the proviso to section 64B(3) indicates a clear policy in cases involving the successive liquidation of a subsidiary and a holding company. The realised capital profits will be exempt as an outgoing dividend distributed by the subsidiary to the holding company in terms of section 64B(5)(c)(ii), but such will not be an exempt incoming accrued dividend when calculating "the net amount" of a dividend declared by the holding company, by virtue of section 64B(3A)(a); *unless* the declaring holding company declares its dividend in the course or in anticipation of liquidation - in which event in the determination of the net amount the holding company is granted a deduction in the amount of the incoming accrued exempt dividend Such, in our view, is the clear intention of paragraph (b) of the proviso to section 64B(3). Put in another way: an incoming accrued dividend exempt in terms of section 64B(5)(c) in the hands of the subsidiary is neither exempt nor deductible for the

purpose of determining STC on a dividend declared by the holding company unless that dividend is declared in the course or in anticipation of the liquidation of the holding company; in which event a deduction to the extent of the exemption in the subsidiary is allowed.

44. It is common cause that the allowable deduction for appellant under paragraph (b) of the proviso to section 64B(3) is the amount of R206 080 510, being the amount exempt from STC in DA under section 64B(5)(c). Such amount is also contained within the disputed amount of R305 311 541 claimed as exempt in terms of section 64B(5)(c). The disputed amount, it will be recalled, is made up of the R275 million dividend and the balance of the share premium account after deducting the original cost of the shares and the capital profits attributable to the period after 1 October 2001. If the appellant's interpretation of the provisions and the formula is correct, the amount of R206 080 510 will benefit from an exemption in DA, a further exemption in the appellant and a deduction in appellant. Had the appellant sold the shares in DA to C (Pty) Ltd, rather than the business as a going concern, it would have received only an exemption in terms of section 64B(5)(c) in respect of the price it received for the shares. STC would then have been payable on the redeemed loan and the returned share premium distributed to the appellant's shareholder.

45. Counsel for the appellant accordingly has urged us to accept as permissible both the exemption and deduction in the holding company of an amount previously having benefited from an exemption in the

subsidiary. He submitted that the language of section 64B(5)(c) and paragraph (b) of the proviso to section 64B(3) permit exactly that. We think the section read as a whole does not mandate such favourable treatment. The subject matter of these provisions is the STC treatment of incoming dividends including distributions of profits of a capital nature. Normally such distributions will be exempt in the hands of the declaring company by virtue of section 64B(5)(c)(ii) and will not be subject to STC. The amount of R61 430 895 received by the appellant for the sale of its shares in the other subsidiaries is a good example. The exemption in terms of section 64B(5)(c)(ii) applies generally when the declaring company is in the course of or anticipates liquidation. However, critically, certain profits of a capital nature are evidently treated differently by the section in specific circumstances, namely distributions of profits of a capital nature received from a subsidiary as a liquidation dividend and in respect of which the subsidiary (in the course or in anticipation of liquidation) received a liquidation exemption in terms of section 64B(5)(c). Such distributions of profits of a capital nature, as already explained, are excluded from exempt status in the hands of the holding company in terms of section 64B(3A)(a) read with section 64B(3). The same applies to dividends exempted in terms of section 64B(5)(f) in the hands of the subsidiary. Where the holding company liquidates, as also explained, paragraph (b) of the proviso to section 64B(3) specifically allows a deduction in the amount of the incoming distribution of capital profits.

46. It is a well-established principle of interpretation that a later provision (section 64B(5)(c)) dealing in general terms with the subject matter will not repeal earlier more specific provisions (sections 64B(3) and (3A)) regulating particular aspects of the same subject matter. The aim of the interpreter must always be to reconcile and harmonise the general and specific provisions of the same section. The general exemption in section 64B(5)(c) is narrowed by the specific provisions of section 64B(3) and (3A), which restrict favourable tax treatment to a deduction in cases of successive liquidations. The harmonisation of the two provisions in this way is supported by the underlying legitimate purpose of avoiding double taxation, but also double favourable treatment.

47. To sum up: the STC computation of the appellant is as follows:

<u>Declared Dividend</u>	498 000 000
less: Exempt proceeds from sale of shares	(61 430 895)
less: Exempt profits of a capital nature	(305 311 541)
less: (Accrued Dividends - Excluded)	0
Dividends subject to STC	131 257 564
less: Deduction para (b) of	

proviso to section 64B(3)	(206 080 510)
Net Amount	0

The computation is unsustainable in light of the principles and interpretation expounded above. The amount of R305 311 541 is not exempt. The amounts exempted in DA in terms of section 64B(5)(c) and (f) - R275 million, and the reduction in share premium are not exempt in the appellant. The correct calculation of the STC liability is that done by the Commissioner, namely:

R498 000 000 - R61 430 895 = R436 56 105 - R206 080 510 = net amount of R230 488 595. The STC on the net amount R230 488 595 x 12,5% = R28 811 074, 37.

48. In the result, therefore, the appeal is dismissed.

JR MURPHY
JUDGE OF THE HIGH COURT

I agree

MR NR CRAFFORD-LAZARUS
MEMBER

I agree

MR NA MATLALA
MEMBER