IN THE SOUTH GAUTENG HIGH COURT (JOHANNESBURG)

SITTING AT MEGAWATT PARK

Case Number: 12656

In the matter between:

Mr. A B **Appellant**

and

THE COMMISSIONER: SOUTH AFRICAN REVENUE SERVICE **Respondent**

DELETE WHICHEVER IS NOT APPLICABLE

(1) REPORTABLE: YES/NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED

_____ _____
DATE SIGNATURE

JUDGMENT

C. J. CLAASSEN J:

[1] This is an appeal by a taxpayer against the disallowance by the Commissioner of the South African Revenue Services ("SARS"), of his objection to an assessment raised by SARS in regard to income derived from foreign asssets . The parties agreed to a statement of agreed facts. No evidence was led. The parties argued the appeal based upon the statement of agreed facts, together with certain references to the dossier which was marked as Exhibit A.

[2] For purposes of understanding the issues arising from the agreed facts, it would be necessary to qoute Exhibit A in full which reads as follows:

"The parties hereby agree that the issues in dispute in this matter be resolved by the court on the basis of the following facts, which are agreed to by the parties in order to dispense with the necessity to lead *viva voce* evidence.

1. The appellant resides in the Province of Mpumalanga, but during all times relevant to this appeal, he was resident in Johannesburg, and in the employ of XY SA [Pty] Limited, a wholly owned subsidiary of ST Co Brands Incorporated in the USA, which company was previously known as D Incorporated, hereinafter referred to as D Co, a company listed on the New York Stock Exchange.
2. During the appellant's employment, he participated in the share incentive scheme of D Co., which scheme appears from the document at pages 109 to 118 of the dossier and which allowed employees to take up shares by way of annual tranches in the holding company in the USA where the scheme was administered by a so-called compensation committee consisting of that company's board of directors.
3. In that regard a firm of stock brokers in the USA, ("K & L"), was employed to facilitate option exercises and that firm operated on the basis that after opening an account with it, optionees had two methods of exercising their options, namely a cashless exercise which enabled the optionee to exercise his option and sell the shares in one transaction or a cash purchase exercise, which allowed for the cash payment of the option price and the retention of the shares in the optionee's account for purposes of resale at a later date.
4. In addition, optionees could have opted also for a so-called "target price exercise" in which K & L would effect a cashless exercise when the closing price on the relevant stock on the New York Stock Exchange exceeded the option price.
5. The optionee could have exercised an option by giving notice to D Co. in the manner specified from time to time.
6. Over the period 1 December 1997 until 4 September 2003 the Appellant exercised various options deriving a nett gain of R2 822 932 which he failed to account for to the respondent for tax purposes, thus resulting in respondent having to raise additional tax assessments in terms of Sections 79 and 8A of the Act on 31 May 2007, as well as interest for the underpayment of provisional tax arising from such non disclosure.
7. Included in the amount of R2 822 932 was a gain of R1 476 447 derived during the 2002 tax year, namely on 22nd January 2002, from the exercise of an option to acquire 10 000 shares at $13.63 per share, when the market value was $26.25, thus realising a net gain of $12.63 per share which converted into R1 476 447 at an exchange rate of R11.69 per Dollar.
8. However the exercise of the above option was followed by the simultaneous sale of the shares on the New York Stock Exchange at the same values and the transfer of the proceeds by K & L into an offshore account held by the appellant with T Co. on the Isle of Man. On 28 February 2003 there still remained un-repatriated and in contravention of the exchange control regulations of the S A Reserve Bank, a balance of £59 850 [R755 682] arising from this transaction, as appears from the statement at page 107 of the dossier.
9. The said amount was also not declared for tax purposes, as required by the Income Tax Act, and therefore the appellant availed himself of an exchange control and accompanying tax relief application on 26 February 2004 in terms of the Exchange Control Amnesty Act No. 12 of 2003 ("the Amnesty Act"), as per the application appearing at pages 97 to 104 of the dossier.
10. The legislation provided for two forms of tax relief under the Amnesty Act, namely exchange control and accompanying tax relief and domestic amnesty. The appellant applied for exchange control amnesty and accompanying tax relief. The amnesty and accompanying tax relief was duly granted per letter dated 20 June 2005, and applied in respect of all tax years up to 28 February 2002 as per correspondence appearing at page 106 of the dossier.
11. In filing the relevant application the appellant was assisted by his accountant of the firm A Chartered Accountants Incorporated, who advised him regarding the form of the application and the requirements of the Amnesty Act, and who was responsible for the filing of such application on behalf of the appellant.
12. However, in issuing the relevant assessment for the 2002 tax year, the respondent did not recognise the amnesty concerned as being applicable to the income in question and proceeded to raise an additional assessment for an amount of R620 107 plus interest in terms of Section 89 *quat*, amounting to R573 670 as appears from annexure A at page 86 of the dossier."

It is on the aforesaid facts which this appeal has to be determined.

THE ISSUES

[3] The issues raised in this appeal are the following:

1. Whether the amnesty and the accompanying tax relief applied for and granted to the taxpayer extends to the value of the gain made by the taxpayer, as a result of the exercise of the right to acquire marketable securities.
2. Whether the respondent can now, after having initially allowed the objection in respect of additional tax and penalties levied in terms of the assessment, request this Court to order that additional tax and penalties be levied afresh.

I shall deal with these two main issues *seriatim*.

THE AMNESTY AND ACCOMPANYING TAX RELIEF.

[4] It is common cause that the gain acquired by the appellant in exercising the option establishes income in his hands which would be taxable as such in terms of Section 8A(1)(a). This provision reads as follows, and I quote:

> "8A(1)(a). There shall be included in the taxpayer's income for the year of assessment, the amount of any gain made by the taxpayer after the 1st day of June 1969 by the exercise, cession or release during such year of any right to acquire any marketable security (whether such right is to be exercised, ceded or released in whole or part), if such right was obtained by the taxpayer before 26 October 2004 as a director or former director of any company or in respect of services rendered or to be rendered by him as an employee to an employer."

[5] It is common cause that at all relevant times, the appellant was an employee of the subsidiary company of D Co., which was registered in the Republic of South Africa. It is also common cause that the exercise of the option realised the benefit of marketable securities which he otherwise would not have had. It is therefore common cause that such benefit should have been disclosed in his 2002 tax return. It is common cause that the appellant did not do so. The reason why the appellant failed to do so is because of his reliance upon the approval of his application for exchange control regulations and accompanying tax relief pursuant to the provisions of the Amnesty Act.

[6] SARS rejected this as a justifiable reason for the appellant's failure to disclose the gain on the following basis. On 27 October 2008, SARS disallowed the appellant's objection on the basis that the amnesty applied for and granted to the appellant did not cover the gains made by the appellant. The respondent's attitude was that of the two possible applications for amnesty the appellant applied for the wrong one and should have applied for amnesty in terms of the provisions regarding domestic tax in the Amnesty Act.

[7] The Amnesty Act came into force on 31 May 2003. It is important, for purposes of this judgment, to refer to this particular Act to understand its scope and application. The preamble of this Act reads as follows, and I quote:

> "Recognising that the objectives of the exchange control amnesty and accompanying tax measures are (a) to enable violators of exchange control regulations and certain tax acts to regularise their affairs in respect of foreign assets attributable to those violations; (b) to ensure maximum disclosure of foreign assets and to facilitate repatriation thereof to the Republic; and (c) to extend the tax base by disclosing previously unreported foreign assets."

[8] To my mind it's quite clear that the Act was designed to grant amnesty to those who had contravened exchange control regulations and tax provisions in order to regularise their position by making a full disclosure of gains from foreign assets. The appellant was such a person who had contravened the exchange control regulations in regard to the exercise of the option and the transfer of the funds upon the sale of the shares to an off-shore account and also transgressed the Tax Act No 58 of 1968 by failing to disclose such gain as provided for in Section 8A(1)(a).

[9] It is common cause that the shares in this particular case constituted "foreign assets", as defined in Section 1 of the Act and, as previously stated, it is common cause that the appellant was at all relevant times a resident of the Republic of South Africa. As such, he was entitled to apply for the amnesty provided for in that Act.

[10] The further relevant provisions of the Act are the following, and I quote:

> "6(2) An applicant contemplated in Section 31B, who applies for the tax relief in respect of foreign income as contemplated in Section 15, must, a, Disclose the receipts and accruals for the last year of assessment of that applicant, ending on or before 28 February 2003,

> which relate to any foreign asset held by that applicant on 28 February 2003, the value of which has been wholly or partly derived from receipts or accruals from a source outside the Republic that were not declared to the Commissioner in any previous year of assessment, as required by the Income Tax Act, 1962; and b, include a description of the identifying characteristics and the location of that foreign asset.
>
> (3) An applicant contemplated in Section 31B, who applies for the domestic tax relief, as contemplated in Section 17 must, (a) disclose the amounts that were not declared to the Commissioner as required by the Estate Duty Act 1955, or the Income Tax Act 1962 (other than receipts and accruals contemplated in sub-section 2A) to the extent that those amounts were accumulated as or converted to foreign assets.
>
> 9(2) To the extent that an applicant applying for tax relief in respect of foreign income, as contemplated in Section 15, complies with Section 6(2) in respect of any foreign assets, the amnesty unit must, subject to Section 10, grant approval that Section 15 applies in respect of the receipts or accruals from a source outside the Republic from which that foreign asset has been derived.
>
> (3) To the extent that an applicant applying for domestic tax relief, as contemplated in Section 17, complies with Section 6(3) in respect of any amount not declared to the Commissioner as required by the Estate Duty Act 1955, or the Income Tax Act 1962, which relates to a foreign assets, the amnesty unit must, subject to Section 10, grant approval that Section 17 applies in respect of that amount."

[11] Section 10 is not relevant to the present appeal, save to say that it deals with instances where the amnesty unit shall not grant approval as contemplated in Section 9. The further relevant provisions of the Act are the following, and I quote:

> "15 An applicant with approval in terms of Section 9(2) shall not be liable for payment of any amount in terms of the Income Tax 1962, and shall be deemed not to have committed any offence in terms of that Act in respect of any receipts or accruals from a source outside the Republic during any year of assessment ending on or before 28 February 2002, which were not declared to the Commissioner, to the extent that those receipts or accruals represent or are included in (a) any foreign asset in respect of which that applicant has made disclosure in terms of Section 6(2); or (b) any further foreign asset which is no longer held by that applicant as at 28 February 2003, otherwise than as a result of a donation of that foreign asset by that applicant.
>
> 17 An applicant with approval in terms of Section 9(3) shall not be liable for the payment of any tax or duty, (a) in respect of any amount which is equal to the amount accumulated as or converted to foreign assets as disclosed in terms of Section 6(3); and (b) which could have been imposed in terms of the Estate Duty 1955, or the Income Tax Act 1962 on or before the date of that accumulation or conversion, and that applicant shall be deemed not to have committed any offence in terms of those acts to the extent of any amounts so disclosed."

[12] As stated previously, the respondent's attitude was that, because the appellant was a South African resident and employed by the South African subsidiary of D Co., the overseas gain was actually accumulated in South Africa because of such residency and employment. On that basis the respondent contended that the gain was not from outside the Republic but generated within the Republic and therefore should have been dealt with under the provisions of Section 17 and not Section 15.

[13] The crux of this case is therefore to decide whether the marketable securities gained by the appellant were from outside the Republic or not. Of importance in deciding this question is the fact that the definition of "gross income" in the Tax Act was amended on 1 January 2001 to read as follows, and I quote:

> "Gross income in relation to any year or period of assessment means (i) in the case of any resident, the total amount in cash or otherwise received by or accrued to or in favour of such resident; or (ii) in the case of any person other than a resident, the total amount in cash or otherwise received by or accrued to or in favour of such person from a source within or deemed to be within the Republic, during such year or period of assessment …"

[14] It will be noticed that the taxable gross income of a taxpayer is dependent on the taxpayer being a resident and that he had received cash or any other amount that accrued to him while a resident, as defined in (i) above. Previously the definition of gross income was differently defined by referring to an amount which had been received or which accrued to a tax payer "from a source which is within the Union or which is deemed to be within the Union." This definition of income caused substantial difficulty because it required a figurative interpretation of where such income originated from. It has been stated that, metaphorically speaking by legal fiction, income may have a situation in a place determined by accepted legal rules. Furthermore, the word "source", when used as it is in order to symbolise the origin of income received by a taxpayer, is also a metaphorical expression and the sense in which it is used in the Act must be determined.

[15] The problem of interpretation is to determine what is the source from which it has been received and when that has been determined, to locate it in order to decide whether or not it was within the Republic. See in this regard, **Commissioner for Inland Revenue *v* Lever Brothers and Unilever Limited,** SA Tax Cases, Volume 14(1) AD at page 8. In that case Watermeyer CJ, held in regard to the understanding of the word "source", as follows, at page 8:

> "The word 'source' has several possible meanings. In this section it is used figuratively, and when so used in relation to the receipt of money, one possible meaning is the originating cause of the receipt of the money; another possible meaning is the quarter from which it is received."

[16] Watermeyer CJ then refers to certain decisions which indicate that cases have

been decided where the source was defined with reference to the originating cause of its receipt, rather than the quarter from where it was received. At page 10 the learned Chief Justice then proceeds as follows, and I quote:

> "Turning now to the problem of locating a source of income, it is obvious that a taxpayer's activities, which are the originating cause of a particular receipt, need not all occur in the same place and may even occur in different countries, and consequently, after the activities which are the source of the particular "gross income" has been identified, the problem of locating them may present considerable difficulties, and it may be necessary to come to the conclusion that the "source" of a particular receipt is located partly in one country and partly in another…such a state of affairs may lead to the conclusion that the whole of a receipt, or part of it, or none of it is taxable as income from a source within the Union, according to the particular circumstances of the case. But I am not aware of any decision which has laid down clearly what would be the governing consideration in such a case."

[17] The essence of the argument on behalf of the respondent is that the gain received by the appellant was sourced in South Africa, because of his employment and residence here. However, income is no longer attached to a definition defining the taxability thereof to the source of its location. As indicated previously, the income which is taxable in the hands of a taxpayer is purely dependant upon the fact that he or she is a resident and that it constitutes cash or other amounts received or accrued. From whence it comes, is no longer important to decide whether it is taxable gross income. The figurative approach to the source of income, is no longer important for purposes of defining whether or not it constitutes taxable gross income.

[18] What is important for this case, is whether or not the income received by the appellant fell within the four corners of Section 15 or Section 17 of the Amnesty Act. Section 15 clearly refers to undeclared foreign income from a source outside the Republic, whereas as Section 17 refers to income of undeclared amounts which have arisen within the Republic. It is now that simple. One must therefore decide whether or not the amnesty, for purpose of taxability, falls within either of these two sections. If it fell within the ambit of Section 17 then of course the appellant should have applied for taxable relief and not amnesty in terms of the Act referring to exchange control regulations and accompanying tax relief, which of course would fall within the ambit of Section 15.

[19] In my view the facts as set out in the agreed statement of facts overwhelmingly indicates that the income was from a source outside the Republic. However, even if I'm

incorrect in this conclusion then, at the very best, the income would constitute income generated partially from outside and partially from within the Republic as contemplated by Watermeyer CJ, in the **Unilever** case, referred to above. In such a case it would seem to me that a court will then have to decide on probabilities whether the balance is in favour of holding such income, to have been derived from a source outside the Republic or not. Alternatively, it may be necessary for a court to decide what portion of such income was derived from a source outside the Republic and what portion derived from within the Republic.

[20] In my view it is not necessary to make a decision in this regard in the present matter, as I'm of the view that the agreed facts clearly indicate that the income of the appellant was entirely from a source outside the Republic. I say this for the following reasons:

1. The shares applied for are shares in a holding company based in the United States of America. The shares were not shares in the local subsidiary of D Co.
2. The entire option scheme was administered by a committee residing in the United States of America. It is their decision which determines whether or not a particular applicant would be afforded such shares or not. Such decision is not made in South Africa but in America.
3. The facilitators operating the entire scheme is a stock broking firm, K & L based in the United States of America. Their address to which any application is to be addressed is their address in America and not their address, if they do have such an address, in South Africa.
4. For purposes of establishing what the gain was, the difference between the market value and the option value have to be calculated and the market value was determined by the value of such share at the relevant time on the New York Stock Exchange. No value in respect of the shares had to be calculated with reference to any stock exchange within the Republic.
5. In the present instance, the money which was realised was realised when the shares were sold on the New York Stock Exchange, which of course is outside the borders of the Republic.
6. Thereafter the proceeds of such sale was transferred from America to an offshore account held in the Isle of Man in the United Kingdom.
7. Legally speaking, the contract for those shares came into existence, not in South

Africa but in the United States of America. I say this for the reason that the scheme itself determines that it will be governed by the laws of the State of North Carolina, situated in the United States of America. It is those laws which will determine whether or not a contract had come into existence. However, even if South African law were to have been applied, in order to determine when and where a contract came into being, it will result in the same conclusion. In this regard Christy, the Law of Contract in South Africa, fifth edition, page 68, states the following, and I quote:

> "As a general rule, a contract is not concluded until the offeree has not only decided in his own mind to accept the offer, but has communicated his acceptance to the offeror. Whatever doubts the old Roman Dutch writers may have had on this point, our courts have had none. And, indeed, it must follow logically from the fact that our law of contract is founded on agreement that, in general, there can be no contract until the offeror knows that he and the offeree are *ad idem*, the offeree already knowing this from the terms of the offer, and the fact of his own acceptance."

[21] Applying this South African principle, the contract would in any event only have come into existence once the appellant had accepted the offer by submitting his application and it was received by K & L in America, acting as a facilitator or agent on behalf of D Co. This is also clear from the terms of the scheme regarding the manner in which the application for such shares is to take place. In clause 3 of the terms and conditions, appearing at page 111 of the dossier, the provisions regarding the exercising of the options are set out. In this regard it is stated that the registered owner may exercise options by "giving notice of exercise to D Co. in the manner specified from time to time by D Co." This, to my mind, is clearly an indication that the contract would only have come into existence in America, once D Co. received notice of the appellant's acceptance in taking up the offer to apply for such shares. This is repeated in Section 6c of the D Co.'s share power plan as it appears on page 115 of the dossier. Again, it is stated there that to exercise an option the holder thereof, shall give notice of his or her exercise to D Co. or its agent, specifying a number of shares or common stock to be purchased and identifying the specific options that are being exercised.

[22] For all of the aforesaid reasons I'm of the view that the weight of the indicators as contained in the agreed statement of facts, point to only one conclusion and that is that the gain received by the appellant originated from a source outside the Republic and not within the Republic. That being the case, the appellant was therefore correct in

applying for the amnesty as stated in sections 6(2) and 15 of the Amnesty Act and not for local tax relief as provided for in Section 17.

[23] I'm therefore of the view that the respondent's reasoning in disallowing the objection based upon the type of amnesty afforded the appellant, was ill conceived and wrong. The respondent should have allowed such objection instead of disallowing it.

ENTITLEMENT TO LEVY INTEREST AND PENALTIES AFRESH

[24] I then come to the next point in issue and that is whether or not the respondent is now entitled to ask this court to reinstate the penalties and interest which it had previously assessed and then withdrawn. This is to be seen in the letter disallowing the appellant's objection dated October 2008, as it is found on page 81 of the dossier. In paragraph 2 thereof, the decision of the National Enforcement Unit Objection Committee is recorded. It appears from paragraph 2 that the objection to the additional tax levies was allowed as well as the objection to the penalties. Mr X for SARS, submitted that that decision was incorrect, and should now be overruled by this court and the additional tax and penalties should be reinstated.

[25] In my view that is not permissible in law. Section 81(5) of the Income Tax Act expressly states as follows, and I quote:

> "81(5). Where no objections are made to any assessment or where objections have been allowed in full or withdrawn, such assessment or altered assessment, as the case may be, shall be final and conclusive."

[26] In my view, applying that particular subsection to the decision of the aforesaid committee, as recorded in the letter by SARS, referred to above, the allowance of the objection to the additional tax and penalties raised by the respondent is final, and cannot be reversed.

[27] I am therefore of the view that there is no basis in law permitting this court to reverse those decisions and to impose additional tax and penalties afresh. However, even if this court was permitted to do so, it would, in my view, follow from the conclusion on the first issue, that it would be inappropriate to do so as, indeed, the

income upon which such additional tax and penalties would have been levied, was obtained from a source outside of the Republic and for which the appellant obtained amnesty. Once such amnesty is obtained the appellant is therefore entitled to have those taxes and penalties reversed. By law, this court would not be entitled to make any other decision in regard thereto.

[28] For the aforesaid reasons, I'm of the view that the appeal should succeed, both in regard to the capital tax and the Section 89 *quat* interest levied. I therefore make the following order:

1. The assessment in regard to the capital tax of R1 476 447 and R755 682, as well as the Section 89 *quat* penalty interest levied upon such amounts, are hereby set aside.
2. The appellant's records should be corrected by the respondent to reflect the aforesaid order.
3. The respondent is ordered to pay the plaintiff's costs.

DATED THE 18TH OF MAY 2010 AT MEGAWATT PARK

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C. J. CLAASSEN
JUDGE OF THE HIGH COURT

Counsel for Aplicant: Adv C. Van Breda
Counsel for SARS: Mr. N. Xulu.
Matter was heard on 17 and 18 May 2010