REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(JOHANNESBURG)

CASE NO: 13512

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

30 MARCH 2015 **FHD VAN OOSTEN**

In the matter between

ABC (PTY) LTD **APPELLANT**

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **RESPONDENT**

J U D G M E N T

VAN OOSTEN J:

INTRODUCTION

[1] This appeal concerns the liability of the appellant in 2010 and 2011 for the payment of secondary tax on companies (STC) in respect of deemed dividends. The Commissioner raised the assessment of STC, including interest thereon, in terms of s 64B(2) read with s 64C(2)(g) and s 64B(9) of the Income Tax Act 58 of 1962 (the Act), in respect of interest-free loans made by the appellant to its shareholders or connected persons, in the 2010 and 2011 years of assessment (the disputed assessments).

[2] The amounts assessed in terms of the disputed assessments, which remain in issue in this appeal are, first, STC on interest-free loans of R38 236 740 in the 2010 year of assessment and second, STC on interest-free loans of R55 270 582 in the 2011 year of assessment, together with interest thereon in terms of section 64B(9) of the Act. It is common cause between the parties that the amount of R18 791 878 in respect of the 2010 interest-free loans was in fact made available in 2009 and therefore incorrectly included in the total amount of the 2010 interest-free loans. On this aspect counsel for the parties are in agreement that the appeal should succeed at least in part in respect of the amount of R18 791 878.

BACKGROUND

[3] The background facts to this matter are either common cause or have not been disputed. First it is necessary to put the appellant in its proper corporate environment as for its relationship with and connection to its shareholders and connected persons.

[4] The appellant forms part of what is loosely referred to as the X Group. The core business of the group is the development of and investment in industrial and commercial property. The founder and master brain of the group is the patriarch, Mr X. An organogram of the various entities that the X Group consists of, shows the X Family Trust as the central entity, which holds shareholding either in full or proportionate in the other entities, which all have some connection to the X family. Of those entities, altogether 12 were borrowers of funds that were provided by the X Trust, as well as a further X family trust, known as the Y Trust and Mr X personally (collectively, the lenders). The shareholding in the appellant was wholly owned by the X Family Trust. The interest-free loans which are the subject of the disputed assessments were made to borrowers in the X Group when funding was needed for particular ventures, which were regarded as ‘high risk’ investments. The appellant, a property owning company, in addition to its core activities, was used as a ‘treasury company’ in the X Group. The loans were made interest-free to the appellant by the lenders (the incoming loans) and channelled to the borrowers by way of interest-free loans to them (the outgoing loans). The appellant, put differently, merely acted as a conduit in the loan transactions. The financial statements of the appellant bear witness to the fact that, although the outgoing loans did not always match the exact

amount of the incoming loans at any particular time, the incoming loans on balance exceeded the outgoing loans. It is important to bear in mind that the appellant's income and profits were never used to fund the outgoing loans. As opposed hereto interest bearing loans were also made but then only in respect of the X Group's core activities, but they do not form part of the disputed assessments.

[5] The appellant relied on and the disputed assessments were based on interest-free loans made by the appellant to its shareholders or connected persons, as I have alluded to. As for the nature of the loan agreements the appellant relied upon a tacit term of the incoming loans that they would be lent interest-free to the borrowers. I am satisfied that the evidence, the surrounding circumstances and conduct of the parties justify the inference of a tacit contract as contended for by the appellant (*Botha v Coopers & Lybrand* 2002 (5) SA 347 (SCA) 360).

THE BASIS OF THE DISPUTED ASSESSMENTS AND THE APPELLANT'S OBJECTION

[6] The Commissioner based the raising of the disputed assessments on the contention that the appellant's advancement of the loans to its connected persons constituted interest-free loans and are therefore deemed dividends which are subject to STC in terms of the Act and that the appellant's failure to pay the STC triggered the payment of interest in terms of s 64B(9) of the Act.

[7] The appellant's objection to the disputed assessment, relevant for present purposes, is principally based on the exemption provided for in s 64C(4)(bA) of the Act, for the contention that the loans did not constitute deemed dividends and that interest did not become payable.

[8] As is clear from what I have thus far set out to the appeal turns on the interpretation of the relevant provisions of the Act. I therefore propose to first set out the legislative framework relevant to the issues and then to interpret the relevant sections of the Act with reference to the issues.

THE LEGISLATIVE FRAMEWORK

[9] The levying of STC has come and gone. It was introduced in 1993 by the insertion of s 64B (forming part of Part VII) into the Act. As was to be expected, amendments extending into numerous subsections followed in 2003, 2004, and 2005 which finally contains the form of the sections at the time relevant to this appeal.

[10] The principles applicable in interpreting the relevant provisions are set out by Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) as follows:

'[18] … The present state of the law can be expressed as follows: Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective, not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. …The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.'

[11] Counsel for the appellant referred us to the budget speech of the Minister of Finance when the proposed introduction of STC was announced and submitted that it should serve as an aid to interpreting the relevant sections of the Act. Counsel furthermore referred to the SARS Comprehensive Guide to Secondary Tax on Companies as well as an explanatory memorandum which accompanied the amended sections introducing s 64C in the Act, setting forth guidelines and explanations much in line with the budget speech of the Minister. The principle that background material can provide a context for the interpretation of a statute was recognised and confirmed in the judgment of the Constitutional Court in *S v Makwanyane* 1995 (6) BCLR 665 (CC) para [13] – [17], to which we were referred by

counsel for the Commissioner. In my view however, I do not consider it necessary to go that far: the provisions of the relevant sections of the Act, against the background of the principle involved in levying STC on dividends, in my view sufficiently provides for a proper interpretation thereof (see *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para [18]; *City of Tshwane v Marius Blom and ano* [2013] 3 ALL SA 481 (SCA)).

[12] In terms of s 5 of the Act, companies (like any other taxpayer) are assessed to pay income tax levied on the amount of 'taxable income' received by or accrued to them during a 'year of assessment'. In addition, companies at the time were subject to STC which was levied at the rate of 10% on the net amount of any dividend declared by that company. Section 64B(2) read as follows:

'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 10 per cent of the net amount, as determined in terms of subsection (3), of any dividend declared by any company, other than a headquarter company, which is a resident.'

[13] Interest was provided for in s 64B(9) as follows:

'If any company fails to pay any amount of secondary tax on companies in full within the period concerned contemplated in subsection (7), interest shall be paid by such company on the balance of the tax outstanding at the prescribed rate reckoned from the end of the period concerned.'

[14] Section 64C was the deeming provision and it provided:

'(2) For the purposes of section 64B, an amount shall, subject to the provisions of subsection (4), be deemed to be a dividend declared by a company to a shareholder, where-

(a) ...

(g) any loan or advance is granted and made available to that shareholder or connected person in relation to that shareholder;'

[15] Subsection (4)(bA), on which reliance is placed by the appellant, provided for an exemption as follows:

'(4) The provisions of subsection (2) shall not apply-

….

(bA) to the extent of any consideration received by that company in exchange for-

(i) the cash or asset distributed, transferred or otherwise disposed of; or

(ii) any other benefit granted as contemplated in subsection (2);'

[16] The deeming provision drew into the tax net the amounts relevant to the circumstances referred to in s 64C(2), on the basis that those amounts were deemed dividends and therefore subject to STC. The term dividend, of course, is central to and of paramount importance in interpreting the provisions. It was defined at the time, in s 1, as 'any amount distributed by a company … to its shareholders …' but was given an extended meaning in subjecting such amounts to certain inclusions and exclusions. In particular, it excluded any distribution to the extent that it represented a reduction of the capital or share premium of a company. Essentially, therefore, a dividend was a distribution by a company of its profits and the intention of STC was to subject the profits distributed by companies to their shareholders to the liability for payment of tax.

[17] This case is simply about the application of the exemption relied on by the appellant. The main thrust of the appellant's argument is that the appellant, in granting the outgoing loans, did not distribute any of its profits to its shareholders or connected persons. It merely acted as a conduit. This, the argument continued, was not the kind of situation in which the deeming provisions were intended to apply. As much is clear from the provisions of the exemption provision relied on. In my view the argument is unassailable and finds support in the judgment of the Supreme Court of Appeal in *CSARS v Airworld CC and another* [2008] 2 ALL SA 593 (SCA) where in dealing with the purpose, scheme and the mechanics of the interplay between section 64B and section 64C, it was held:

'[23] In an ideal State, where every person, natural or juristic, is aware of the benefits which the population derives from collected tax and of the consequent responsibility to contribute what is due, the legislator would presumably have been content to let section 64B stand on its own. But the legislator in this imperfect world must be ever alert to thwart the relentless

ingenuity of accountants, tax consultants, lawyers and even the lay person, by anticipating possible ways and means by which the prescripts of tax legislation might be avoided. And that was the obvious purpose behind the inclusion of section 64C. The legislator foresaw that a company might find other ways of transferring its profits to its shareholders than by the process of distributing them directly in the form of dividends. *So the "mischief" which the legislator sought to prevent by enacting section 64C was the avoidance by companies of liability for STC, by disguising what was in truth a dividend distribution as some other form of transaction.* In this regard the legislator plainly foresaw two possibilities. Traditionally the recipients of a dividend declared by a company are the shareholders. The first possibility was that the company might make the payment (or transfer the benefit measurable in money), not to the shareholder, but to a person associated with the shareholder who would be in a position, informally, to pass it on to the shareholder. Such an arrangement would make it difficult, if not impossible, for the Commissioner to identify the transaction as the distribution of a dividend. This was plainly the reason for the broadening of the class of "recipients" in subsection (1). The second possible "loophole" which the Legislature sought to close related to the type of transaction, under the guise of which what was effectively the payment of a dividend, could be made. The result was the deeming stipulation in subsection (3), in which various means of transferring a benefit measurable in money from the company to the recipient are listed.' [Emphasis added]

[18] The general principle underlying the levying STC on dividends is for the State to share in the profits of a company. It is for that purpose that STC was introduced on dividends as well as deemed dividends. In the present case dividends do not arise. Nor do deemed dividends arise.

[19] Counsel for the Commissioner submitted that the exemption relied on by the appellant does not apply as the loans we are here concerned with, in order to qualify must comply with the provisions of s 64C(4)(d), which provides for the exemption of 'any loan granted in respect of which a rate of interest not less than the "official rate of interest" as defined in paragraph 1 of the Seventh Schedule is payable by the shareholder or any connected person in relation to the shareholder'. The argument proceeded from the premise that the exemption in ss (4)(d), on the application of the maxim *expressio unius est exclusion alterius,* provided for the kind of loan to be exempted. That led to the conclusion that the interest-free loans we are here concerned with, did not comply with the provisions of the ss (4)(d) and are therefore not exempted. In my view the maxim does not apply in the interpretation of the

exemption provisions. It is trite that for purposes of interpretation it does not always follow that the mention of one matter implies the exclusion of others. The maxim must in any event at all times be applied with great caution (see *SA Estates and Finance Corporation Ltd v CIR* 1927 AD 230 at 236). I find it impossible in this case, having regard to the wording and purpose of the subsection, to apply the maxim. Had it been the intention of the legislature that only loans of the kind referred to in ss (4)(d) would qualify for exemption, one would have expected clear words to that effect of which there are none (cf *Defy Ltd v CSARS* 2010 (5) SA 416 (SCA) para [46]).

[20] This brings me to the main argument advanced by counsel for the Commissioner. It is this: no consideration within the meaning of the exemption relied on was received by the appellant in return for the interest-free loans advanced to the borrowers. I am unable to agree. The consideration, or *quid pro quo*, as correctly pointed out by counsel for the appellant, lies in the nature of the loan agreements: in essence the appellant was granted equivalent benefits in the form of the interest-free incoming loans as consideration in exchange for the amounts it loaned by way of interest-free outgoing loans. The outgoing loans matched the benefits the appellant received by way of incoming loans. It accordingly clearly constituted a *quid pro quo* which the appellant received in return for making the outgoing loans. Counsel for the Commissioner made much of the words 'to the extent of any consideration received' as militating against the appellant's contention. The relevance thereof escapes me. The incoming and outgoing loans, by their nature, as I have alluded to, clearly qualify for the exemption.

[21] One last aspect. The only witness to testify in the appeal was Ms Z. She is the daughter of Mr X and the financial director of the appellant since 2007. In her evidence, which was not challenged, she dealt with the general set-up and business activities of the X Group as well as the nature of the incoming and outgoing loans with reference to the financial statements of the appellant. Only one aspect of her evidence, which perhaps may cause unease, needs to be addressed. Ms Z readily conceded that the use of the appellant merely as a conduit for the purpose of effecting the incoming and outgoing loans was, as she chose to describe it, 'bizarre'. Let me immediately lay all fears to rest: nothing sinister in the arrangement was

either relied on by the Commissioner or suggested in argument before us. As counsel for the appellant correctly remarked, tax payers are entitled to arrange their affairs in the manner they wish as long as the confines of the law are respected.

[22] For all the above reasons the appeal must succeed.

ORDER

[23] In the result the following order is made:

1. The appeal is upheld.

2. The disputed assessments are set aside.

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FHD VAN OOSTEN
JUDGE OF THE HIGH COURT

I agree.

_____
MS S MAKDA
ACCOUNTANT MEMBER OF THE COURT

I agree.

_____
MR GC KOFFMAN
COMMERCIAL MEMBER OF THE COURT

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ATTORNEYS RESPONDENT	***THE STATE ATTORNEY***
DATES OF HEARING	***18, 19 & 20 MARCH 2015***
DATE OF JUDGMENT	***30 MARCH 2015***