

**IN THE TAX COURT OF SOUTH AFRICA  
(HELD AT CAPE TOWN)**

Case No: 13193

In the matter between:

**ABC (PTY) LIMITED**

Appellant

and

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

Respondent

**Date of Hearing:** 25 – 29 July and 15 September 2016

**Judgment:** 22 February 2017

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**JUDGMENT**

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**INTRODUCTION AND ISSUES FOR DETERMINATION**

1. This appeal concerns the validity and the correctness of the additional assessments made by the Commissioner for the South African Revenue Service ('the Commissioner', 'SARS' or 'the respondent') on 2 December 2011 in respect of the income tax assessments for 2008 and 2009 of ABC (Pty) Ltd ('ABC' or 'the appellant').<sup>1</sup>

2. In terms of the additional assessments, the appellant's taxable income was adjusted by the inclusion of the further amounts of R29 468 127 in respect of the appellant's 2008 year of assessment and R67 062 945 in respect of the appellant's 2009 year of assessment.

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<sup>1</sup> The respective years of assessment ended on 31 March 2008 and 31 March 2009.

As explained hereunder these amounts correspond with the aggregate annual total amount of so-called dividend rights, ceded by D Bank to ABC in its 2008 and 2009 years of assessment, which were included in the appellant's gross income for those years.

3. Similar assessments were made on three other related companies, GH (Pty) Ltd, JK Holdings (Pty) Ltd and LM Ltd. The appellant and these three other companies are all subsidiary-companies of D Bank and D Bank is the holder of 100% of the ordinary shares in all of them. By agreement between the parties the outcome of this appeal will be decisive of the disputes in respect of these three subsidiary companies.

4. The appellant's objection against the assessments on 23 December 2011 was disallowed by the Commissioner on 25 January 2012. On 24 February 2012, the appellant lodged an appeal against the disallowance of the objection, thus giving rise to the present proceedings.

5. The issues to be determined in this appeal are the following:

- 5.1. Whether the value of the dividend rights, ceded by D Bank to the appellant, constitutes 'gross income' in the hands of the appellant, as an amount of interest accruing to the appellant by virtue of the provisions of section 24J(3) of the Income Tax Act 58 of 1962 ('the Act');
- 5.2. Whether, in the alternative, and in the event of a finding that section 24J of the Act is not applicable, the value of the ceded dividend rights, in any event, constitutes 'gross income' in the hands of the appellant;
- 5.3. Whether, in the event of a finding that these dividend rights fall to be included in gross income on one of the above bases, the respondent is precluded from raising additional assessments, because the original assessments were made in

accordance with the '*practice generally prevailing*' as at the date of the original assessments, as envisaged in section 79(1)(iii) of the Act;

- 5.4. Whether, if the assessments are upheld, the Commissioner should have remitted interest under section 89*quat*(3) of the Act; and
- 5.5. Whether the Commissioner is liable for the appellant's cost pertaining to the appeal.

## LEGISLATIVE FRAMEWORK AND RELEVANT LEGAL PROVISIONS

6. Certain of the provisions of the Act on which the appellant relies were amended subsequent to the years of assessment in question, or have subsequently been repealed and replaced by equivalent provisions of the Tax Administration Act 28 of 2011, as amended, ('the TAA') which came into force on 1 October 2012. As the years of assessment in dispute were prior to the coming into force of the TAA, the repealed provisions of the Act relied on by ABC remain applicable to this dispute. The provisions that require consideration in this appeal, some of which have been repealed since the relevant assessments were made, are, for the sake of convenience, summarized or quoted as follows:

- 6.1. '**Gross income**' is defined in section 1 of the Act, in respect of residents in the Republic of South Africa, as the total amount, in cash or otherwise, received by or accrued to or in favour of such resident, during a year or period of assessment, excluding receipts or accruals of a capital nature, but including certain specified amounts. Paragraph (k) of the definition of '**gross income**' specifically includes any amount received or accrued by way of a dividend.

6.2. **'Income'** is defined in section 1 of the Act as –

‘the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II;’ The heading of Part 1 which contains sections 5 to 37 is **'Normal Tax'**.

6.3. **'Shareholder'** is defined in section 1 of the Act, at all times relevant to this appeal, as:

‘the registered shareholder in respect of any share, except that where some person other than the registered shareholder is entitled, whether by virtue of any provision in the memorandum or articles of association of the company or under the terms of any agreement or contract, or otherwise, to all or part of the benefit of the rights of participation in the profits, income or capital attaching to the share so registered, that other person shall, to the extent that such other person is entitled to such benefit, also be deemed to be a shareholder’.

6.4. **'Taxable income'** is defined in section 1 as –

‘the aggregate of—

- (a) the amount remaining after deducting from the income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income; and
- (b) all amounts to be included or deemed to be included in the taxable income of any person in terms of this Act;’

6.5. Section 10 deals with exemptions from normal tax and section 10(1)(k)(i) provides that dividends received by, or accrued to, any person will be exempt from normal tax. Section 10(1)(k)(i) is qualified in certain respects by provisos

which result in certain dividends not qualifying for exemption. Proviso (ee), which was added to section 10(1)(k)(i), came into operation on 10 January 2012 and was amended on 25 October 2012. This proviso, as amended, reads as follows:

‘(ee) to any dividend received by or accrued to a company in consequence of—

(A) any cession of the right to that dividend; or

(B) the exercise of a discretionary power by any trustee of a trust,

unless that cession or exercise results in the holding by that company of all of the rights attaching to a share;’

6.6. Section 7 provides that income is deemed to have accrued or to have been received by a person in certain specific instances set out in that section.

6.7. In terms of section 11(a) of the Act it is stipulated that, for the purpose of determining the taxable income, expenditure and losses actually incurred in the production of the income shall be allowed as deductions from the income, provided that such expenditure and losses are not of a capital nature.

6.8. Relevant extracts from section 24J of the Act, with the heading ‘**Incurral and Accrual of interest**’, include:

6.8.1. Definitions in sub-section 1 of section 24J, more specifically the following:

‘**accrual amount**’, in relation to an accrual period, means an amount determined in accordance with the following formula:

$$\mathbf{A = B \times C}$$

in which formula—

(a) "A" represents the amount to be determined;

- (b) "B" represents the yield to maturity; and
- (c) "C" represents the adjusted initial amount.

**'accrual period'**, in relation to an instrument, means—

- (a) where in terms of such instrument regular payments at intervals of equal length and not exceeding 12 months per interval are to be made throughout the term of such instrument, the period between such regular payments; or
- (b) any period not exceeding 12 months elected by the holder or issuer, as the case may be,

which period shall be applied consistently throughout the term of such instrument;

**'yield to maturity'** means the rate of compound interest per accrual period at which the present value of all amounts payable or receivable in terms of any instrument in relation to a holder or an issuer, as the case may be, of such instrument during the term of such instrument equals the initial amount in relation to such holder or issuer of such instrument: Provided that where—

- (a) such instrument is a variable rate instrument, such rate of compound interest shall be calculated with reference to the variable rate applicable on the date such rate of compound interest is to be calculated to determine all amounts payable or receivable after such date;

- (b) in the case of a variable rate instrument the variable rate in relation to such instrument changes, the rate of compound interest shall be redetermined in relation to such variable rate instrument with reference to—
  - (i) the appropriate adjusted initial amount in relation to such variable rate instrument determined before such change in the rate; and
  - (ii) such changed variable rate applicable on the date such rate of compound interest is to be redetermined to determine all amounts payable or receivable after such date;
- (c) any variation in the terms or conditions of such instrument takes place which will result in a change in such rate of compound interest in relation to such instrument, the rate of compound interest shall be redetermined in relation to such instrument with reference to the appropriate adjusted initial amount in relation to such instrument determined before such variation; or
- (d) there is a variation or alteration—
  - (i) of the rights or interests of a holder in relation to an income instrument in respect of any amounts receivable in terms of such income instrument, the rate of compound interest in relation to such income instrument shall be redetermined in respect of such holder with reference to the appropriate adjusted initial amount in relation to such income instrument determined before such variation or alteration: or

(ii) in the obligations of an issuer in relation to an instrument in respect of any amounts payable in terms of such instrument, the rate of compound interest in relation to such instrument shall be redetermined in respect of such issuer with reference to the appropriate adjusted initial amount in relation to such instrument determined before such variation or alteration.

**'initial amount'** means the issue price or transfer price, as the case may be, in relation to an instrument.

**'issue price'**, in relation to an instrument, means the market value of the consideration given or received, as the case may be, for the issue of the instrument as determined on the date on which that instrument is issued;

**'adjusted initial amount'** means—

- (a) in relation to the holder of an income instrument with regard to a particular accrual period, the sum of the initial amount and the accrual amounts in relation to all previous accrual periods and any other payments made by such holder during all such previous accrual periods less any payments received by such holder during all such previous accrual periods, in terms of such income instrument; or ...

**'holder'**, in relation to an income instrument—

- (a) means any person who has become entitled to any interest or amount receivable in terms of such income instrument; or

- (b) at any particular time, means any person who, if any interest payable in terms of such income instrument was due and payable at that time, would be entitled to receive payment of such interest;

**'Issuer'**, in relation to any instrument—

- (a) means any person who has incurred any interest or who has an obligation to repay any amount in terms of such instrument....'

**'income instrument'** means—

- (b) in the case of any company, any instrument.

**'instrument'** means any form of interest-bearing arrangement whether in writing or not, including—

- (a) any bond, debenture, bill, promissory note, certificate or similar arrangement;
- (b) any deposit with a bank or other financial institution;
- (c) any secured or unsecured loan, advance or debt;
- (d) any acquisition or disposal of any right to receive interest or the obligation to pay any interest, as the case may be, in terms of any other interest bearing arrangement; or
- (e) any repurchase agreement or resale agreement, ...'

**'interest'** includes the—

- (a) gross amount of any interest or related finance charges, discount or premium payable or receivable in terms of or in respect of a financial arrangement....'

6.8.2. Sub-sections (2) and (3) of section 24J stipulating as follows:

(2) Where any person is the issuer in relation to an instrument during any year of assessment, such person shall for the purposes of this Act be deemed to have incurred an amount of interest during such year of assessment, which is equal to—

- (a) the sum of all accrual amounts in relation to all accrual periods falling, whether in whole or in part, within such year of assessment in respect of such instrument; or
- (b) an amount determined in accordance with an alternative method in relation to such year of assessment in respect of such instrument,

which must be deducted from the income of that person derived from carrying on any trade, if that amount is incurred in the production of the income;

(3) Where any person is the holder in relation to an income instrument during any year of assessment, there shall for the purposes of this Act be deemed to have accrued to that person and must be included in the gross income of that person during that year of assessment (whether or not that amount constitutes a receipt or accrual of a capital nature), an amount of interest which is equal to—

- (a) the sum of all accrual amounts in relation to all accrual periods falling, whether in part or in whole, within such year of assessment in respect of such income instrument;
- or

- (b) an amount determined in accordance with an alternative method in relation to such year of assessment in respect of such income instrument.

6.8.3. Section 24J(10) which reads as follows:

‘(10) Any reference in this section to any payment made or an amount paid or payable, consideration given or received or any payment received or an amount received or receivable, as the case may be, shall be construed as including a payment or an amount or consideration otherwise than in cash.’

6.9. Section 64B of the Act was applicable during the 2008 and 2009 years in question and deals with secondary tax on companies (STC). With effect from 1 April 2012 dividends tax replaced STC. However, in the relevant years of assessment (2008 and 2009) the dispensation pertaining to secondary tax on companies was applicable. In sub-section 2 of section 64B it is stipulated that STC is calculated at a rate of 10% of the net amount (as determined in terms of sub-section 3) of any dividend declared by any company.<sup>2</sup> The net amount of any dividend is defined in sub-section (3) as the amount by which the dividend declared by a company exceeds the sum of any dividends which have accrued to that company during the dividend cycle as defined in sub-section 1 of section 64B and subject to certain further qualifications.

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<sup>2</sup> Sub-section 2 was amended by section 68(1)(b) of Act No 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 January 2011 and at the relevant time the rate in question was 12.5%.

- 6.10. Section 76I of the Act, repealed by the TAA, but applicable to the years of assessment in question provides as follows:

**‘Section 76I—Nonbinding private opinions and other written statements—**(1) The Commissioner may issue a nonbinding private opinion to a person regarding the tax treatment of a particular set of facts and circumstances or a particular transaction.

(2) A nonbinding private opinion does not have any binding effect upon the Commissioner.

(3) A nonbinding private opinion may not be cited in any proceeding before the Commissioner or the courts other than a proceeding involving the person to whom the nonbinding private opinion was issued. ...’

- 6.11. Section 79 of the Act, repealed by the TAA but applicable to the years of assessment in question, dealt with additional assessments. In section 79(1) the circumstances in which the Commissioner was entitled to raise an additional assessment in respect of amounts which were subject to tax and should have been assessed to tax under a previous assessment, but were not so assessed, were set out.

Proviso (iii) to section 79(1) provided that the Commissioner shall not raise an additional assessment: ‘if the amount which should have been assessed to tax under the original assessment referred to in sub-paragraph (i) of this proviso was, in accordance with the practice generally prevailing at the date of the assessment, not assessed to tax, or the full amount of tax which should have been assessed under such assessment was, in accordance with such practice, not assessed;’

- 6.12. Part IIA of Chapter 3 of the Act containing sections 80A to 80L came into operation on 2 November 2006, and stipulates that an avoidance arrangement is impermissible if its sole or main purpose is to obtain a tax benefit and certain other prescribed circumstances are present. These provisions are known as the general anti-avoidance provisions.
- 6.13. Section 81 of the Act, repealed by the TAA, dealt with objections against assessments and in terms of sub-paragraph (4), the Commissioner may, on receipt of a notice of objection to an assessment, alter the assessment or disallow the objection.
- 6.14. In terms of section 89*quat*(2) of the Act, SARS is empowered to impose interest on the difference between the tax ultimately held to be payable and the provisional tax paid by the taxpayer which is calculated from the effective date, i.e. six months after the last day of the year of assessment in question, up to the date of the additional assessment. Section 89*quat*(3) furthermore allowed the commissioner to direct that no interest, or limited interest, shall be paid by the taxpayer in certain circumstances.
- 6.15. Sub-section (1) of section 103 of the Act which was repealed in 2006 and replaced by the general anti-avoidance provisions in Part IIA of Chapter 3, contained the general anti-avoidance provisions applicable prior to 2006.
- 6.16. Section 129 of the TAA provides in sub-section 1 for an appeal to be decided on the basis that the burden of proof is upon the taxpayer. In sub-section 2 of the section 129 it is stipulated that the tax court may confirm or alter the assessment or decision or refer the assessment back to SARS for further examination and assessment.

- 6.17. In terms of section 130 of the TAA the tax court may in dealing with an appeal and on application by an aggrieved party grant an order for costs in favour of the parties, if, inter alia, the SARS grounds of assessment or decision are held to be unreasonable (sub-section (1)(a)).
- 6.18. Section 269(1) of the TAA stipulates that rules, notices and regulations issued under the provisions of a tax Act repealed by the TAA that are in force immediately prior to the commencement date of the TAA remain in force until new rules, notices and regulations are issued under equivalent provisions of the TAA.
- 6.19. In terms of section 269(3) of the TAA rulings and opinions issued under the provision of a tax Act repealed by the TAA and in force immediately before the commencement date of the TAA which have not been revoked are regarded as having been issued under the authority of the TAA to the extent relevant to and consistent with the TAA.
- 6.20. Section 270(2)(d) of the TAA provides that an objection and appeal instituted under the provisions of a repealed tax Act, but not completed by the commencement date of the comparable provisions of the TAA must be continued and concluded under the provisions of the TAA as if taken or instituted under the TAA.
- 6.21. In respect of the 2008 and 2009 tax years the Rules promulgated under section 107A of the Act on 1 April 2003 prescribed the procedure to be observed in respect of the noting of appeals and the conduct and hearing of appeals before a tax court. In these Rules it is provided that any taxpayer is entitled to object to an assessment and, if dissatisfied with a decision of the Commissioner in terms

of section 81(4) of the Act to disallow an objection, may appeal against that decision. Rule 10 requires the Commissioner to deliver to the taxpayer a statement of the grounds of assessment and Rule 11 for the taxpayer, within sixty days after the delivery by the Commissioner of the statement of the grounds of assessment, to deliver a statement of the grounds of appeal. In Rule 12 it is stipulated that the issues in any appeal to the tax court will be those defined in the statement of the grounds of assessment read with the statement of the grounds of appeal.

## **THE FACTUAL BACKGROUND**

7. At the hearing the appellant presented the evidence of Mr X and Mr Y both employees in the financial products division of D Bank. The respondent tendered the evidence of Mr S, a consultant at its large business centre, and Dr T, an employee of the respondent since 2010 and a senior specialist in investigative audits. It must be noted that all these witnesses impressed us as credible professionals. Although there are no relevant factual disputes between the parties, these witnesses nonetheless offered valuable background evidence to elucidate the background facts relevant to the legal disputes between the parties, as set out hereunder.

8. At all relevant times ABC and the other three subsidiaries of D Bank, referred to in paragraph 3 above, operated redeemable preference share businesses. ABC raised preferent share capital from investors who subscribed for redeemable preference shares issued by it. ABC was then obliged to pay dividends to such investors in respect of the redeemable preferences shares. The proceeds raised were utilised to invest in redeemable preferences shares issued by corporate entities with acceptable credit standings, on the basis that such investment would yield greater dividends than the dividends paid to the preferent shareholders,

thereby making a profit of the difference between the dividends earned and the dividends paid. Given the nature of the business these preference share companies would, according to the appellant, at times find themselves either with surplus cash requiring to be invested in preference shares or with a shortfall of capital while it tried to find new investors to raise the necessary capital.

9. In about the year 2000 companies involved in the financial services industry, commenced establishing investment offerings aimed at providing dividend returns to investors. These generally contained dividend cessions as a feature where dividends were ceded antecedently, after the date of the declaration of such dividends, but prior to the last day for registration as shareholder, (the 'LDR' or 'record date'), in order to qualify for the dividend. During the period 2000 to 2005 a number of dividend income funds were considered and/or implemented for example, P Limited Share Trust, G Fund, H Dividend Fund, NO Dividend Income Fund, R Bank Dividend Income Fund, V Bank Dividend Income Fund and U Dividend Income Fund.

10. On 27 March 2000 the late Dr E SC furnished an opinion pertaining to the proposed G Fund dividend income unit trust fund. In this opinion Dr E advised that the obligation of the bank involved in that scheme to provide a return on the deposit cannot be construed as an obligation to pay interest. He also advised that the proposed scheme did not constitute a transaction, operation or scheme which fell within the ambit of section 103(1) and that section 24J would not apply. In letters dated 21 and 22 November 2000 SARS expressed its agreement with the opinion of E.

11. D Bank and its employee, X, D Bank's consultant in respect of financial products, were involved in establishing the V Bank Dividend Income Fund. V Bank invested funds with D Bank and these funds were invested by D Bank in unlisted preference shares, an investment that

could not have been made by V Bank due to the regulatory environment in which it operated as a collective investment scheme. V Bank's return on the investment with D Bank consisted of dividends, the rights to which were antecedently ceded by D Bank to V Bank. X attended a meeting with SARS employees in Pretoria and thereafter, at D Bank's request, SARS furnished V Bank with a written ruling dated 21 October 2003 to the effect that dividends to be ceded to V Bank by D Bank would retain their character as dividends in V Bank's hands, and be exempt from income tax in terms of section 10(1)(k)(i) of the Act. It was also concluded in this ruling that section 24J of the Act would not apply.

12. In respect of the V Bank structure an opinion was obtained from a certain Dr Z advising that the proposed structure was valid and permissible from a tax perspective. At D Bank's request, SARS furnished V Bank with a written ruling dated 21 October 2003. In this ruling concurrence with Dr Z's opinion regarding the application of section 103(1) to the structure was expressed. It was furthermore intimated that the dividends to be ceded to V Bank by D Bank would retain their character as dividends in V Bank's hands, and be exempt from income tax in terms of section 10(1)(k)(i) of the Act, and that section 24J of the Act would not apply.

13. D Bank also sought and obtained opinions from E on 9 June 2006 and 15 November 2006 wherein he advised that –

13.1. The contingent right to dividends thus transferred to the preferent share company prior to the accrual of any right to the future payment of the dividends would in due course give rise only to tax exempt dividends; and

13.2. Section 24J of the Act would not apply to the transactions.

14. Because D Bank, ABC and X were aware of the favourable treatment of the V Bank fund and some of the other dividend income funds, ABC and D Bank proceeded with plans for a

similar structure, in terms of which D Bank would purchase rights to future dividends declared by listed companies from NO and/or MM Bank and to on-cede same to ABC before the last day of registration (LDR or record date). The perception was that such dividends would be tax-exempt in terms section 10(1)(k)(i) of the Act and the dividend rights would therefore not constitute income subject to tax in the hands of a preference share company such as ABC. Furthermore, that the dividends received by ABC under such circumstances would confer a secondary tax on companies (STC) credit that would offset the liability for STC arising when a preference share company declared dividends to its shareholders. The envisaged structure would obviously have tax advantages for ABC.

15. Prior to this, ABC had lent its surplus funds to D Bank at zero interest. Pursuant to this structure, ABC would therefore go from a zero interest (zero tax) return to an exempt (zero tax) dividend return, thereby assisting in creating reserves and liquidity to enable ABC to declare and pay dividends on the preference shares that it had issued. The idea was to earn tax-exempt dividend income and pay non-tax deductible dividends to its preferent shareholders. In D Bank and ABC's opinion this structure would achieve valuable commercial purposes.

16. The underlying contracts to establish the envisaged structure were entered into in 2007. D Bank entered into agreements with NO and MM Bank and a further agreement with ABC and the other D Bank subsidiaries referred to above.

17. The NO and MM Bank agreements were similar in content and the NO agreement, entered into on 2 February 2007, contained the following relevant provisions:

17.1. The term 'dividend rights' is defined in the agreement as NO's right, title and interest in listed shares owned by NO that NO has placed in its untaxed policyholder fund for the purposes of section 29 of the Act, which dealt with the

taxable income of companies carrying long-term insurance business (since repealed).

- 17.2. D Bank shall be entitled to offer to purchase from NO, its dividend rights.
  - 17.3. When D Bank wishes to make such offer it shall deliver a confirmation to NO at any time on or after the dividend declaration date, but prior to the LDR. Such confirmation shall constitute an offer by D Bank to purchase the applicable dividend rights.
  - 17.4. Upon the acceptance of the confirmation by NO, NO sells and cedes on an out and out basis its dividend rights to D Bank. The dividend rights are sold voetstoots.
  - 17.5. The purchase price payable by D Bank to NO for the dividend rights were always greater than 100% and an amount equal to 102.5% at a certain point in time of the nominal value of the subject dividends.
  - 17.6. In clause 6.3 NO warrants to D Bank that it shall be the beneficial owner of the dividend rights and that it shall be entitled to sell and cede these dividend rights to D Bank and that it shall not have sold or encumbered these dividend rights.
18. On 24 April 2007, ABC and the other D Bank subsidiaries, referred to above, entered into a master investment agreement with D Bank and on 12 November 2007 into an amendment and restatement agreement in terms of which the parties agreed to amend and restate the master investment agreement. In terms of the amended master investment agreement ('the master agreement') ABC would from time to time invest in 'composite indivisible notes' issued by D Bank. These notes yielded a return in the form of dividends and the issue of the notes entitled ABC to obtain, by way of antecedent cession from D Bank rights to dividends declared by companies listed on the JSE. In terms of clause 5.2.2 it is provided that 'the Note is a composite indivisible note comprising of capital and dividend rights and accordingly ABC shall

not be entitled to sell or otherwise dispose of the rights to the capital under the Note independently of the rights to the capital under the Note or vice versa'.

19. D Bank deducted the cost of acquiring the dividend rights from NO and/or MM Bank, and it is not disputed that this expenditure was correctly deducted by D Bank. This is because it was incurred in the production of the income which D Bank earned from borrowers when it lent them the funds secured when ABC invested in the composite note.

20. The agreements, referred to in paragraph 15 and 16 above, resulted in ABC acquiring dividend income as a return on its capital so invested, and enabled ABC to utilise the resultant reserves to pay dividends to its preferent shareholders, as a supplement to the dividends received from its own investments in redeemable preference shares.

21. The structure established under these agreements can be summarised as follows:

21.1. ABC made an investment with D Bank by paying it the 'issue price' of a note, the effect of which was that ABC paid a capital amount to D Bank for the note and D Bank undertook to repay an identical capital amount to ABC by a specified date.

21.2. The note entitled ABC to a return on such investment transaction in the form of dividend rights antecedently ceded by D Bank to the appellant.

21.3. D Bank was obliged to redeem the note and repay the issue price on certain specified dates.

21.4. D Bank satisfied its obligations in respect of the 'dividend amount', as it was required to do, by acquiring from NO and/or Old MM Bank, and on-ceding to ABC, rights to future dividends declared by listed companies.

21.5. ABC in its tax returns included the dividend income received on the exercise of its dividend rights in its gross income as defined in section 1 of the Act in the

years of assessment in which they were received, and deducted the said amounts from its gross income by virtue of the dividend exemption provision in terms of section 10(1)(k)(i) of the Act. The reserves as well as the cash flow arising from the accrual and subsequent receipt of such dividends were then utilized to pay dividends to ABC's preference shareholders, in respect of which payment no income tax deduction was claimed by ABC.

22. The aggregate annual amount of dividend rights ceded by D Bank to the appellant in the 2008 and 2009 years of assessment corresponded to amounts referred to in paragraph 2 above. SARS duly assessed ABC on the above basis in the original assessments for 2008 and 2009 dated 13 August 2008 and 31 March 2010 respectively.

23. In a letter dated 2 November 2009 SARS forwarded a questionnaire to D Bank, relating to specific transactions, prevalent in the financial services industry entered into after 1 January 2005. D Bank was specifically required to state whether it acquired and/or sold any dividends or rights to dividends.

24. D Bank responded to the questionnaire in a letter dated 10 February 2010 and referred to the fact that composite notes were issued to V Bank and to its own preference share subsidiary companies, which had been unable to secure appropriate underlying investments, but still required dividends to enable these subsidiaries to service obligations to preference shareholders. The ruling obtained from SARS dated 21 October 2003 in respect of V Bank, referred to above, was also annexed to this response.

25. During the budget speech on 23 February 2011 it was specifically intimated that dividend schemes undermine the tax base and would be closed by treating the dividends at issue as ordinary revenue and that these schemes include dividend cessions, where taxpayers effectively purchase tax-free dividends without any stake in the underlying shares.

26. In the 2011 Budget Review the National Treasury deals with the closure of dividend cession schemes in the following terms: 'Several dividend schemes undermine the tax base. One method involves the use of dividend cessions, where taxpayers effectively purchase tax-free dividends without any stake in the underlying shares. Another scheme involves the receipt of dividends from shares in which the taxpayer has no meaningful economic risk (e.g. has an offsetting derivative position). Some arrangements make use of preference shares that generate allegedly tax-free dividends while the dividends are indirectly generated from interest-yielding debt. All these schemes will be closed by treating the dividends at issue as ordinary revenue'.

27. In the explanatory memorandum to the draft Taxation Law Amendment Bill, 2011 dated 2 June 2011, the proposed amendment to section 10(1)(k)(i) is discussed and the following is stated: 'Many companies regularly purchase dividends via cessions solely due to their tax-free nature so as to undermine the tax system. These purchases would simply not exist but for the tax arbitrage. Dividend cessions occurring after dividend declaration especially lack any non-tax commercial rationale'. In this memorandum it is furthermore explained that the proposed amendment would, 'eliminate the tax-free nature of dividends obtained by way of cession and for dividends in respect of shares held only momentarily'.

28. The same statement appears in a document issued by SARS 'Tax proposals budget 2011' and in a media statement of the budget speech of 23 February 2011 dated 2 June 2011 the following appears – 'In addition these bills treat dividend cessions as ordinary revenue, as well as dividends in respect of long-held shares when matched by offsetting short positions.'

29. In a SARS letter to ABC dated 1 June 2011, the following information was requested:

29.1. The face value of each dividend right ceded to ABC as a result of the holding of each note acquired and held by ABC, and in each case the effective date of the cession.

- 29.2. A description of how the note was classified by ABC for financial reporting purposes.
  - 29.3. The nature of the *quid quo pro* given by ABC for the dividend right ceded by D Bank.
  - 29.4. A description of the accounting and tax treatment of the dividend right and the dividend income ultimately accruing to ABC.
  - 29.5. The applicable statutory provisions in respect of a transaction treated as exempt or non-taxable in terms of any tax legislation.
30. D Bank responded on behalf of ABC on 24 June 2011 as follows:
- 30.1. Following the subscription of the dividend yielding composite notes, ABC was not entitled to any other dividend rights than the dividend rights received as described in the amended and restated master investment agreement.
  - 30.2. ABC is a wholly owned subsidiary of D Bank and for financial reporting purposes ABC's investment in the composite notes have been reflected as amounts owing by Group Companies under the balance sheet category 'non-current assets'.
  - 30.3. Besides the payment of the issue price to D Bank no *quid quo pro* was given by ABC.
  - 30.4. In accordance with the master investment agreement ABC became entitled to a return on the investment in the form of dividends, the right to which were antecedently ceded by D Bank in favour of ABC. Particulars were also furnished of certain accounting entries.
  - 30.5. In terms of section 10(1)(k) the dividends accruing to ABC were exempt from tax. For STC purposes dividends accruing to ABC were taken into account in determining the net amount of dividends referred to in section 64B(3).

31. Thereafter the SARS letter of findings dated 27 July 2011 ('the LOF'), dealing with the tax treatment of dividend rights ceded by D Bank to ABC was forwarded to the appellant. In the LOF the provisions of section 24J were fully dealt with and ABC was informed that the provisions of section 24J would be applied to the notes and the dividend rights ceded by D Bank to ABC during the 2008 and 2009 years of assessment and that the aggregate annual amount of the dividend rights ceded and transferred during each of the 2008 and 2009 years of assessment would be treated as an amount of interest accruing to ABC in respect of each such year of assessment. ABC was furthermore advised that the notices of assessment may reflect an amount of interest imposed in terms of section 89*quat*(2) of the Act and that ABC may, in terms of section 89*quat*(3) request a deduction or remission of such interest. ABC was further advised that an additional tax of 200% must be imposed in terms of section 76I, but that the Commissioner is entitled to remit such additional tax in whole or in part provided certain provisions are met.

32. ABC responded to the LOF in a letter dated 14 November 2011 and denied that the notes were interest-bearing arrangements as contemplated in section 24J of the Act. It is also pointed out that, in order for an amount to accrue, there must be an unconditional entitlement to such amount. It was also intimated that the basis upon which it is sought to tax ABC did not constitute the SARS practice generally prevailing at the time when the original assessments were made.

33. In an adjustment to the taxable income for the years 2008 and 2009 dated 2 December 2011 SARS advised ABC of the additional taxable income in respect of 2008 and 2009. For the first time additional amounts equal to the dividends which had accrued to ABC were included in 'gross income', purportedly in terms of section 24J(3) of the Act. SARS' interpretation of section 24J(3) was extensively dealt with in this letter and ABC's response to the LOF was also fully dealt with and rebutted. In respect of section 76I of the Act and the imposition of additional

tax of 200% percent, ABC was informed that additional tax would be waived in full. Notwithstanding the appellant's representations SARS intimated that interest would be imposed in terms of section 89*quat*(2) of the Act.

34. In terms of a letter dated 23 December 2011 D Bank objected to the additional assessments of 2 December 2011. The grounds of objection included the following:

- 34.1. The so-called dividend rights did not constitute interest as defined in section 24J(1);
- 34.2. The notes were neither interest-bearing arrangements, nor instruments, as defined in section 24J(1) of the Act;
- 34.3. The notes were not income instruments as defined in section 24J(1) of the Act;
- 34.4. The taxpayer was not a holder in relation to each note as defined in section 24J(1) of the Act;
- 34.5. From inception it was not, nor was it subsequently possible, to calculate a yield to maturity as defined in section 24J(1) of the Act;
- 34.6. There were and are no accrual amounts as defined in section 24J(1) of the Act;
- 34.7. The Commissioner carries the burden of proof in respect of the existence of an 'amount' as contemplated in the definition of gross income in section 1 of the Act, but he/she has not established and cannot establish the existence or the quantum of any such amount;
- 34.8. The so-called dividend rights gave rise to neither a receipt, nor an accrual in favour of the taxpayer; and
- 34.9. The original assessment for the 2008 and 2009 years of assessments were made in accordance with the practice generally prevailing at the date thereof and the Commissioner was therefore precluded from raising the additional assessment for these years in terms of the proviso embodied in section 79(1)(iii).

35. In terms of Act 24 of 2011 section 10(1)(k) of the Act was amended by the addition of a further proviso (ee) with the result that the exemption would not apply to any dividend received by or accrued to or in favour of a company in consequence of a cession or any right of that company acquired in consequence of any cession.

36. In a letter dated 25 January 2012 SARS responded to each of the objections contained in the letter of 23 December 2011 referred to in paragraph 32 above and the objections were disallowed.

37. On 24 February 2012 ABC appealed to the tax court against the additional assessments for the 2008 and 2009 years of assessment.

38. In the Commissioner's statement of the grounds of assessment in terms of rule 10 the Commissioner contended that –

38.1. The dividend right (the right to a dividend declared by a company that has not yet accrued by virtue of the LDR not yet having arrived) ceded to the appellant is the vesting of something of value in the appellant and constitutes an amount (for the purposes of the Act) in that:

38.1.1. Such a right constitutes incorporeal property; and

38.1.2. It has money value equivalent to the face value of the declared dividend payable on the LDR.

38.2. The basis for the additional assessments in respect of the 2008 and 2009 years of assessment were identified as including the following:

38.2.1. The dividend rights and the income rights received by the appellant from D Bank constitute interest as defined in section 24J(1) of the Act and the

amounts accruing to the appellant are included in the appellant's gross income and taxable by virtue of section 24J(3) of the Act.

38.2.2. In the alternative the Commissioner contends that the dividends fall to be included in gross income on the basis that they accrue to the appellant as a compensation for monies lent to D Bank and not by virtue of it being a dividend having an exempt character in terms of paragraph (k) of the definition of 'gross income'. The Commissioner therefore contended that the amounts accrued to the appellant do not fall to be exempt from normal tax in terms of section 10(1)(k) of the Act.

39. On 4 May 2016 appellant's amended statement of the grounds of appeal in terms of rule 11 was filed. In these grounds of appeal the appellant repeated that –

39.1. The only amounts which formed part of the appellant's gross income were the amounts of dividends which actually accrued to the appellant pursuant to the cession by D Bank of the contingent rights to dividends.

39.2. The contingent rights to dividends were of a capital nature in the hands of appellant and did not themselves constitute gross income in the hands of the appellant. The cession of the contingent rights to dividends did no more than set up the machinery in terms of which the dividends themselves would in due course accrue.

39.3. Neither the contingent rights to dividends, nor the unconditional rights to dividends which replaced and superseded them constituted interest in the hands of the appellant.

39.4. The burden of proving the existence of any alleged amount is on the Commissioner.

## **APPLICATIONS FOR LEAVE TO AMEND**

40. In my view it is not necessary to rule on the respective applications of the respondent and the appellant to amend their rule 10 and rule 11 statements. The matter was argued on the basis of these amendments had been granted. Mr S, SC, who appeared with Mr C for the respondent, indicated that SARS was not persisting with its objection to the appellant's application for leave to amend.

41. In so far as the appellant persists with its objection to the respondent's application for leave to amend, it appears that the case of *DS v CSARS*<sup>3</sup> is relevant. In that matter, the judge in dealing with an application by the commissioner to amend its rule 10 statement, drew a distinction between amendments where the tax appeal is concerned with objective questions of fact and law, on the one hand, and a tax appeal which is concerned with the exercise by the commissioner of powers which he has upon being satisfied of particular matters, on the other hand. The amendment sought by the respondent appears to fall into the former category.

42. This judgment will therefore deal with the disputes between the parties on the basis that both amendments have been granted.

## **THE AMBIT OF THE DISSENT BETWEEN THE PARTIES**

43. For reasons that are set out hereunder, it is only necessary to deal with the first two disputes referred to in paragraph 5.1 and 5.2 above and the question of costs.

44. I agree with the submission of Mr JJ SC, who appeared with Mr KK for the appellant, that the tax position of D Bank cannot impact on how ABC is taxed, unless SARS is contending that there is a tax avoidance scheme under section 80A. In my view, however, the terms of the agreements between D Bank and NO/ MM Bank on the one hand, and between D Bank and its

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<sup>3</sup> [2014] ZATC 5.

preference share subsidiaries on the other hand, are relevant to properly determine the ambit of the disputes between the parties and to understand the relationship between the parties involved in the agreement.

45. It is not in dispute that:

- 45.1. ABC was not assessed on the basis of the general anti-avoidance provisions of the Act (section 80A), but on the basis that an amount of interest had accrued to it under section 24J. Whether or not the overall transactions were ‘tax-driven’ played no role in the assessment.
- 45.2. The *Lategan* principle<sup>4</sup> was upheld by the appeal court in *CIR v People’s Stores (Walvis Bay)*<sup>5</sup> and an amount accrues to a taxpayer when such taxpayer becomes entitled to payment thereof.
- 45.3. An amount can only accrue to a taxpayer once such taxpayer becomes unconditionally entitled to it.<sup>6</sup>
- 45.4. The dividends acquired by ABC as cessionary became unconditional and accrued to ABC on the LDR and were exempt in terms of section 10(1)(k)(i) of the Act.
- 45.5. The onus is on the taxpayer to show, on a preponderance of probability, that the decisions of SARS against which it appeals are wrong. SARS is, however, not free to simply adopt a supine attitude. SARS is bound to set out the grounds for the disputed assessments and the taxpayer is obliged to respond to these grounds of appeal. These would serve to delineate the disputes between the

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<sup>4</sup> *Lategan v CIR* 1926 CPD 203.

<sup>5</sup> *Commissioner for Inland Revenue v People’s Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A) at 363-364.

<sup>6</sup> *Ochberg v CIR* 6 SATC 1 at p8; *Mooi v SIR* 1972 (1) SA 675 (A) at 683G-H and 684D-E.

parties.<sup>7</sup> The burden of proving the existence of an ‘amount’, i.e. of quantifying the value of the alleged ‘dividend rights’ in this instance, however, rests on SARS.<sup>8</sup>

## THE RESPONDENT’S CASE

46. The respondent’s case, in essence, is that the receipt by ABC of the right to dividends prior to the LDR, in contrast to the accrual of the dividends themselves, constitutes an ‘amount’ which is taxable, either as ‘interest’ under section 24J of the Act, or as ‘gross income’ under the definition of that term in section 1 of the Act.

47. The respondent’s approach is that the dividend rights were a separate and distinct accrual in the hands of ABC, which occurred at an earlier point in time and that this accrual is taxable on the basis that it is of a revenue nature and not subject to any exemption. The respondent’s counsel accuses the appellant of confusing the accrual of dividend right as a separate amount, with the accrual of the dividend income that arises on the LDR.

48. Respondent’s counsel agree, as confirmed in *Mooi v SIR*,<sup>9</sup> that for accrual to occur, the taxpayer’s right to claim payment in respect thereof must be unconditional. They, however, contend that the receipt of the dividend rights by ABC was unconditional. In respect of *Mooi*’s case the respondent’s contention is that the court in that matter distinguished the situation where the right in question did not come into existence at all until a condition has been fulfilled and the situation where the right vests immediately. Respondent’s counsel contended that the matter under consideration falls into the latter category, since the dividend rights, as opposed to the dividends themselves, were unconditionally ceded to ABC on an out and out basis by D Bank.

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<sup>7</sup> *CSARS v Pretoria East Motors* 2014 (5) SA 231 (SCA) para 6 at 235E-F.

<sup>8</sup> *Commissioner for Inland Revenue v Butcher Bros (Pty) Ltd* 1945 AD 301 at 322.

<sup>9</sup> Footnote 6 (*supra*) 683A-684G.

49. In respect of conditionality or contingency it is furthermore contended that:
- 49.1. The dividend rights are taxable on the basis that it is of a revenue nature rather than a capital nature.
- 49.2. The uncertainty about the identity of the owner of the dividend rights prior to the LDR, does not render such rights conditional.
- 49.3. The subject matter of the NO agreement is dividend rights sold and ceded to D Bank on an out and out basis. These dividend rights are not subject to any conditions, because of the warranties contained in clause 6.3 of this agreement.<sup>10</sup>
- 49.4. The contractual restriction on ABC's entitlement to dispose of the dividend rights in terms of clause 5.2.2 of the master investment agreement does not result in any conditionality. What the clause does is to recognise that the dividend rights do indeed have a value and that, save for the contractual restriction, these dividend rights so ceded would otherwise have been capable of disposal.<sup>11</sup>
50. As far as accrual of an amount, as referred to in the definition of gross income, is concerned, it is argued that, where the taxpayer receives a *quid pro quo* in return for some or other performance on its own part, the only relevant question to determine whether there is an accrual in the taxpayer's hands, is whether such taxpayer has an unconditional entitlement to receive such *quid pro quo*. In an instance where there is no outstanding unfulfilled conditions that operate to suspend the right to receive the *quid pro quo*, there is accrual. It is also submitted that the dividend rights ceded by D Bank to ABC constitute an 'amount' for the purposes of the definition of 'gross income', which is separately distinguishable from the

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<sup>10</sup> As set out in paragraph 15.6 *supra*.

<sup>11</sup> In this respect reference was made to *CSARS v Brummeria Renaissance (Pty) Ltd* 2007 (6) SA 601 (SCA) at para [15] at 609B-H was relied upon.

dividend income arising from such a right and that such dividend rights accrued to ABC, in that it became unconditionally entitled thereto.

51. The respondent's further contention is that an incorporeal asset, such as a dividend right which has a value, constitutes an amount for purposes of the gross income definition<sup>12</sup> and in support of this claim that the dividend rights have a value, the following submissions are made:

- 51.1. It is evident from their agreement that D Bank and NO placed a value on the dividend right equal to the amount of the dividend to be paid in the future, once LDR was reached, plus an amount of 2.5%.
- 51.2. The dividend rights ceded to the appellant is the vesting of something of value in the appellant's hands and it constitutes 'an amount' for purposes of the Act in that such a right constitutes incorporeal property; and has a money value equivalent to the face value of the declared dividend payable on the LDR.<sup>13</sup>
- 51.3. The appellant could have disposed of this dividend rights in the open market prior to accrual of the dividend.
- 51.4. The value of the ceded dividend rights, as an independent accrual, is also apparent from the master investment agreement, which provides that in the case of the early redemption of the note (i.e prior to the last day of the dividend period), ABC will be required to cede antecedently as an out and out cession to D Bank the reference dividend rights ceded to ABC.
- 51.5. The additional assessments raised by the Commissioner in respect of the appellant's 2008 and 2009 years of assessment took into account the aggregate annual amount of the dividend rights ceded by D Bank to the appellant. In

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<sup>12</sup> *Lategan v CIR* 2 SATC 1; *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301; the *Peoples Stores case (supra)*; *CIR v Delfos* 6 SATC 92 and *Brummeria Renaissance (supra)* footnote 11.

<sup>13</sup> In this respect counsel relied on the decision of the court a quo in *CIR v Cactus Investments* 1999 (1) SA 264 (T) at 312D-H, a judgment by Wunsch J, and *ITC 1375* (1982) 45 SATC 207 at 210.

calculating the aggregate annual amount of the dividend rights each dividend right so ceded was assigned its face value i.e. the value of the dividend receivable in respect of such right.

52. In respect of the interpretation of section 24J and the definitions and provisions referred to in paragraph 6.7 *supra* it is submitted that:

52.1. The definition of 'interest' circularly includes the word 'interest' and therefore does not ascribe a meaning to this word. The term 'interest' is also not further defined in any other part of the Act. With reference to *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>14</sup> and the *Shorter Oxford English Dictionary* it is submitted that the correct definition of 'interest' is 'money paid for the use of money lent or for the forbearance of a debt' and that this definition is consistent with the meaning that our courts have generally given to the notion of interest.<sup>15</sup>

52.2. The appellant's own records, such as the annual financial statements, confirm that the dividend rights sold constitute interest, a finance charge or a premium receivable by the appellant as envisaged in the definition of interest in section 24J(1).

52.3. The dividend rights ceded by D Bank to the appellant in terms of the master investment agreement represent compensation for the use of the money advanced in terms of the investment transaction by the appellant to D Bank and therefore 'interest' (payable in *specie*) as defined in section 24J(1).

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<sup>14</sup> 2012 (4) SA 593 (SCA) para [18].

<sup>15</sup> Reference was made to *ITC 1485 52 SATC 337* and *Cactus Investments (Pty) Ltd v CIR* 1999(1) SA 593 SCA at 323C-D.

- 52.4. The note under the master investment agreement is thus an 'interest bearing arrangement' and accordingly an 'income instrument' as defined in section 24J and ABC is a 'holder' in respect of the income instrument (the note).
- 52.5. Each dividend right is an 'amount' for the purposes of the definition of 'yield to maturity' and the 'yield to maturity' ('YTM') must be calculated taking the issue price and the value of the dividend rights ceded to the appellant into consideration.
- 52.6. ABC is therefore required, in terms of section 24J(3), to include in its gross income for income tax purposes in respect of the 2008 and 2009 years of assessment the aggregate value of all 'accrual amounts' determined in respect of each note, calculated in respect of each 'accrual period' falling within such year of assessment as the product of the YTM applicable to such note and the 'initial amount' (in the first accrual period) or 'adjusted initial amount' (in subsequent accrual period) in relation to such note.
- 52.7. In respect of taxation as gross income, the application of section 24J results in the inclusion in the taxpayer's gross income of the value of the dividend rights it received from D Bank. An alternative method of arriving at the same conclusion would be to apply the definition of gross income to the facts. This would result in a conclusion that the value of the dividend rights constitute an amount that accrued to the taxpayer in the year of assessment, not being of a capital nature.
53. The applicant's viewpoint, that the Commissioner's approach entails double taxation, is countered with the allegation that our courts do not regard objectionable double taxation as occurring where, on the accepted principles for determining this, two or more discrete accruals

arise.<sup>16</sup> There is furthermore no question of double taxation, since the accrual of the ultimate dividend itself will qualify for an exemption.

## INTERPRETATION

54. This matter concerns the interpretation of 'gross income', the words 'accrued to' or 'received by' referred to in the definition of 'gross income' and the provisions of section 24J, more specifically the concept 'interest'.

55. The following principles of legislative interpretation should, in my view, be taken into consideration:

55.1. Legislation must be interpreted positively, properly contextualised and in a manner that best promotes the values of the Constitution.<sup>17</sup>

55.2. Where two or more interpretations of a statutory provision are possible, a court must adopt the interpretation which better promotes the spirit, purport and objects of the Bill of Rights. This is so even if neither interpretation would render the provision unconstitutional.<sup>18</sup>

55.3. It is trite that the process of interpretation, including the interpretation of legislation, is a unitary exercise in which one objectively considers the words utilized in the context of the document as a whole. Consideration must also be given to the purpose of the legislation, and the material known to the legislator at

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<sup>16</sup> *Brummeria* (footnote 11 *supra*) at 611B-E.

<sup>17</sup> *Cool Ideas 1186 CC v Hubbard* 2014 (4) SA 474 CC para 28 at 484F-485A.

<sup>18</sup> *Wary Holdings (Pty) Ltd v Stalwo (Pty) Ltd* 2009 (1) SA 337 CC para 46 at 356C-E, para 84 at 368B-C and para 107 at 376C-F.

the time of promulgation. A reasonable and sensible interpretation is to be preferred.<sup>19</sup>

- 55.4. The presence of ambiguity warrants a resort to so-called secondary aids to construction such as presumptions, i.e. the *contra-fiscum*<sup>20</sup> and the *subsecuto observatio*-rule. The *subsecuto observatio*-presumption entails that a construction of a statute which has long and publicly been acted upon is not likely to be disturbed.<sup>21</sup> In *Commissioner, South African Revenue Service v Bosch* 2015 (2) SA 174 (SCA) at para [17], the following appears:

'There is authority that, in any marginal question of statutory interpretation, evidence that it has been interpreted in a consistent way for a substantial period of time by those responsible for the administration of the legislation is admissible and may be relevant to tip the balance in favour of that interpretation. This is entirely consistent with the approach to statutory interpretation that examines the words in context and seeks to determine the meaning that should reasonably be placed upon those words. The conduct of those who administer the legislation provides clear evidence of how reasonable persons in their position would understand and construe the provision in question. As such it may be a valuable pointer to the correct interpretation. In the present case the clear evidence that for at least eight years the revenue authorities accepted that in a DDS scheme the exercise of the option and not the delivery of the shares was the taxable event, fortifies the taxpayers' contentions.'

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<sup>19</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) paras 18 at 603E-604D and *Bothma-Batho Transport (Edms) Bpk v S Bothma & Seun Transport (Edms) Bpk* 2014 (2) SA 494 (SCA) para 10-12 at 498D-499H.

<sup>20</sup> *LAWSA* Vol 25 Part 1 para 334(A) at page 322 to 323; LC Steyn *Die Uitleg van Wette* (5<sup>th</sup> Ed) p110-111; Devenish *Interpretation of Statutes* (1992) page 169-171; and *CIR v MacNeillie's Estate* 1961 (3) SA 833 (A) at 838F.

<sup>21</sup> *LAWSA op cit* para 370 at 407 and 408; LC Steyn *op cit* p157-159 and Devenish *op cit* para 6 at 136-139.

55.5. Questions of interpretation are matters of law and courts do not receive opinion evidence as to the meaning of a statutory provision. On such questions the opinions of witness, however, eminent or highly qualified (except in regard to words which have a special or technical meaning) are inadmissible.<sup>22</sup>

## DISCUSSION

56. Appellant's counsel, in my view, correctly identified the decisive question in this appeal as whether ABC's right to dividends, pursuant to the antecedent cession of the dividends, but prior to the LDR, as opposed to the dividends themselves, was conditional or not and whether it constituted an amount that accrued to the appellant, either as a deemed accrual in terms of section 24J(3), or in terms of the definition of gross income. In support of this submission the appellant relied on a number of cases, including the following:

56.1. *ITC 1378*<sup>23</sup> where Malamet J dealt with the cession of so-called rights to dividends and held that such rights which have been ceded, are not future rights, but a contingent rights, capable of immediate vestment and divestment by cession.

56.2. *Taxpayer v Commissioner of Taxes (Botswana)*<sup>24</sup> in respect of which the appellant's counsel submitted that the antecedent cession of a right to dividends is nothing but the cession of a contingent right. The word 'antecedent' conveys the cession of a right at a stage when it is still a contingent right that have not yet given rise to any accrual. In this matter a distinction was drawn between a disposal of income after it has accrued and the disposal of a right under which income would only accrue in the future. In that matter it was stated, that in

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<sup>22</sup> *International Business Machines SA (Pty) Ltd v Commissioner for Customs and Excise* 1985 (4) SA 852 (A) at 874A-C; *Starke NO and Another v Schreiber and Others* [2001] 1 All SA 167(C) page 175.

<sup>23</sup> *ITC 1378* 45 SATC 230.

<sup>24</sup> 43 SATC 118 at 131 and 138.

respect of the former situation, as the income has already accrued to the party who disposes of it, it remains taxable in his/her hands and in respect of the latter scenario, the income accrues to the recipient of the right and not to the person who has disposed of the right.

56.3. The seminal *People's Stores* judgment<sup>25</sup> where the *Lategan* principle (the definition of accrual as 'entitled to') was accepted. In that matter it was pointed out that it is the right to receive payment in the future that accrued to the taxpayer and that it is that right that has to be valued and that the value is affected by its lack of immediate enforceability. What accrues is the right to receive payment in the future and this can only mean an unconditional right. If there is any contingency attached, it cannot be said that the right to receive payment in the future exists. An unconditional right to receive payment in the future, therefore accrues, which is also when an amount is receivable for the purposes of section 24J of the Act. The counterpart of this relates to the deductibility of expenditure incurred, to arrive at taxable income. In order for expenditure to be actually incurred, it has been held that there has to be an absolute and unconditional legal liability to pay.<sup>26</sup>

56.4. As stated above the respondent relies on the *Brummeria* judgment,<sup>27</sup> Wunsch's J judgment in the *Cactus* matter,<sup>28</sup> *ITC 1375* and *ITC 1485* in support of their stance. I agree with appellant's counsel that the *Brummeria* case can be distinguished since the taxpayer in that matter provided accommodation rent-free, and as a *quid pro quo* obtained the right to use money advanced by the

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<sup>25</sup> Footnote 5 *supra* at 367F; and *Anglo Platinum Management Service (Pty) Ltd v Commissioner, South Africa Revenue Services* 2016 (3) SA 406 (SCA) para 31 at 414I-415B.

<sup>26</sup> *Nasionale Pers v Komm van Binnelandse Inkomste* 1986 (3) 549 (AA) at 564A-566G.

<sup>27</sup> Footnote 11 *supra*.

<sup>28</sup> Footnote 15 *supra*.

occupiers of the rent-free accommodation, interest-free. The difference in that case was that the taxpayer's right to use the money interest-free was an unconditional right, whereas the contingent rights to dividends acquired by the appellant were conditional on it being the shareholder when the accrual date arrived, which was at a later stage. Wunsch's J judgment in the court *a quo* in *Castus* was obiter and also does not assist the respondent. In my view, *ITC 1375* can be distinguished since the court specifically found that the sale of shares in that matter had the characteristics of a venture in the nature of trade. The court concluded that the gains made by the appellant on the sales of shares in that matter were revenue and formed part of the appellant's income for the specific year of assessment. *ITC 1485*, in my view, rather supports the appellant's contentions than that of respondent. In that matter it was held that *'To permit of its deduction in the year of assessment, an absolute and unconditional legal obligation must have been incurred. ... If the obligation is initially incurred as a conditional one during a particular year of assessment and the condition is fulfilled only in the following year of assessment, it is deductible only in the latter year of assessment'*.

- 56.5. I agree that the effect of *Mooi's* case is that a contingent right, conditional upon the fulfillment of conditions, is not an 'amount' for purposes of the definition of gross income in the Act, despite the fact that such right had a money value at the time that it was acquired by a taxpayer.<sup>29</sup> The respondent suggests that the facts of *Mooi* fall into the category where rights did not come into existence at all because of contingency, whereas the rights acquired by the appellant from D Bank fall into the category of rights vesting immediately. In my view, however,

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<sup>29</sup> *Mooi supra* at 684B-G.

once it is appreciated that the second category relates to unconditional rights, it becomes clear that the matter under consideration is on all fours with *Mooi*. It can certainly not be said that the contingent rights to dividends acquired by ABC from D Bank by antecedent cession were rights which vested immediately, but related to a payment in future. The rights were contingent rights, and an unconditional right only came into existence once the condition was fulfilled.

57. In the *Mooi* judgment<sup>30</sup> it was furthermore found that it is necessary in a case such as the present to distinguish between the 'real and true benefit' for which ABC contracted (to which tax consequences attach) and the contractual machinery set up to deliver that benefit (to which tax consequences do not attach). I associate myself with the appellant's contention that the cession of the contingent dividend rights in this matter can be regarded as a mechanism for the delivery of dividends. Setting up of a mechanism in terms of which a shareholder receives a dividend when it will in due course accrue, differs wholly from both the incurral and the accrual of interest in terms of section 24J. What was paid by D Bank for the contingent dividend rights was paid to NO and/or MM Bank, not ABC. The only amount that was paid to ABC was the actual dividend paid by the JSE listed company of which ABC was a shareholder and not by D Bank. What occurred between D Bank and ABC was merely the cession of contingent rights to future dividends which gave rise to neither taxable accruals nor amounts receivable when they were ceded. The appellant did not become 'unconditionally entitled' to the contingent dividend rights – it simply acquired them as cessionary by way of an antecedent cession, and they did not then give rise to any unconditional entitlement. That came later when the dividends accrued. Akin to what was held in *Mooi's* case, this was simply the setting up of the machinery for the accrual of the dividends that would follow. SARS's inclusion of the alleged value of the so-called 'dividend rights' in ABC's gross income represents, in the language of Ogilvie

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<sup>30</sup> At page 683-684.

Thompson CJ in *Mooi*, *'the artificial concept of valuing appellant's contingent right as at its initial, inchoate, stage'*.

58. I also believe that there is merit in the appellant's contention that the effect of the SARS assessment is that two accruals are included in 'gross income' when there were not two separate commercial accruals. I agree that this SARS approach is commercially insensible. There should be a focus on the true commercial benefit, which is the single accrual of a dividend. In this respect reference was made to *Commissioner, South African Revenue Service v Capstone 556 (Pty) Ltd*<sup>31</sup> where it was stated that *'the correct approach in a matter of this nature is not that of a narrow legalistic nature. What has to be considered is the commercial operation as such and the character of the expenditure arising therefrom. This is perhaps but another way of expressing the concept that it is the substance and reality of the original loan transaction that is the decisive factor.'*

59. In respect of cession it must be remembered that the consequences of cession is that the cessionary succeeds the cedent as creditor of the right and as such is the only one entitled to administer and enforce such right.<sup>32</sup> Cession is a legal manner in which rights are transferred, or delivered, and where what is transferred is a contingent right, an out-and-out cession thereof is merely the manner in which the contingent right is transferred by the cedent to the cessionary, which receives no less and no more than what was ceded, in this case a contingent right.

60. I do not agree with respondent's contention that the uncertainty about the identity of the owner of the dividend right, prior to LDR, does not render the right conditional. The fact of the matter is that the conditionality or contingency of the right must be determined in relation to the accrual of the right in question. Although the right, divorced from the holder of the right may not be contingent, the accrual of the right depends on the identity of the holder and is conditional

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<sup>31</sup> 2016 (4) SA 341 (SCA).

<sup>32</sup> *Lawsa* (2<sup>nd</sup> Edition) Vol 2 Part 2 para 44.

and/or contingent in that respect. The fact of the matter is that 'gross income' is defined as an amount received by or accrued to a resident of the Republic of South Africa, a specific person or entity. In *Chairman, Board on Tariffs and Trade v Volkswagen SA*<sup>33</sup> Nienaber JA dealing with the interpretation of section 12(2)(c) of the Interpretation Act 33 of 1957 pointed out that a right accrues when all the conditions for its existences in relation to the particular beneficiary are met. In this instance the particular beneficiary in respect of a dividend right registered as the shareholder at the time of the LDR.

61. The contingency of the dividend rights, as is the case with the dividends themselves, in my view, arises pursuant to the following circumstances:

61.1. Since the LDR had not yet arrived, the payment of a dividend was conditional on the identity of the shareholder entitled to the dividend being established on the LDR.

61.2. Section 90(2) of the previous Companies Act 61 of 1973, in force at that the relevant time, in terms of which the payment of dividends was prohibited if a company was unable to pay its debts or its liabilities would be more than its assets after the payment embodied a statutory condition that had to be fulfilled before a company could lawfully pay a dividend.

62. I disagree with the respondent's submission that the dividend rights accrue to ABC, because it has a value for the following reasons:

62.1. The dividend rights, as separate and discrete from the dividend itself, cannot have the same value as the dividend, because it is known that the dividend right will disappear as soon as the dividend accrues. Applying the face value of the

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<sup>33</sup> 2001 (1) All SA 519 A para 13 at p525f-i..

dividend to the moribund dividend right in ABC's hands is uncommercial and incorrect.

- 62.2. The contingent dividend rights obviously had a value in the hands of NO or MM Bank, but when that contingent right arrived in the hands of ABC, it had no value apart from the value of the dividend that would follow. It is absurd to accord the same value to both. The true position is that the conditional dividend rights lost whatever value they may have had before the end of the relevant year of assessment. It is only at the end of the year of assessment that it is possible, and imperative, to determine the amounts received or accrued on the one hand and the expenditure actually incurred on the other.<sup>34</sup>
- 62.3. Viewed from the correct vantage point, namely the end of the year of assessment, it is clear that the conditional dividend rights had been replaced by the unconditional dividend rights and indeed the cash dividends themselves. So viewed, the value of the conditional dividend rights was nil. From the vantage point of the end of the tax year, the contingent rights to the dividend therefore had no value at whatsoever.
- 62.4. The mere fact that a conditional right to any payment has value does not necessarily give rise to an entitlement constituting either an 'accrual' (as contemplated in the definition of 'gross income') or an 'amount receivable' (as contemplated in section 24J). An 'accrual' only occurs, and an amount only becomes 'receivable', if and when the contingency disappears, or the condition is fulfilled, and the taxpayer thereby acquires an unconditional right to payment.<sup>35</sup>

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<sup>34</sup> *Caltex Oil (SA) Ltd v CIR* 1975 (1) SA 665 (A) at 674.

<sup>35</sup> *Anglo Platinum Management Services (Pty) Ltd v Commissioner, South African Revenue Services* 2016 (3) SA 406 (SCA) at 414I-415B at para [31].

63. To the extent that there is ambiguity or uncertainty about the correct interpretation of 'gross income' or section 24J, the principles of interpretation referred to above, in my view, support the appellant's contentions for the following reasons:

63.1. The fact that SARS over many years, clearly did not interpret the Act to give rise to an additional accrual in the circumstances under consideration.

63.2. The inclusion of the proviso (ee) to section 10(1)(k)(i) specifically aimed at outlawing the antecedent cession of dividends for tax purposes. Although the respondent claims that there may have been other reasons for the amendment, the factual background, more particularly, the rulings of the respondent and the memoranda in respect of the amendment, in my view, clearly indicate that the legislative amendment of 2012 to include proviso (ee) was aimed at prohibiting arrangements such as the D Bank/ABC agreement.

63.3. An interpretation and application of the Act that recognizes two separate accruals of gross income where only one commercial accrual exists is plainly insensible and unbusinesslike and gives rise to absurd consequences. The effect of the assessment was to include two accruals in gross income when there were not two separate commercial accruals. This artificial and commercially insensible approach is avoided by simply focusing, as the authorities require, on the true commercial benefit, which is the single accrual of a dividend.

64. As far as the dispute about double taxation is concerned, the appellant's counsel referred to *CIR v Delfos*<sup>36</sup> where it was stated that the same amount should not be taxed twice in the hands of the same taxpayer. I agree that what is relevant is whether it is permissible to include what amounts to the same amount in 'gross income' twice and that the prohibition

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<sup>36</sup> 1933 AD 242 at 261.

against double taxation does not operate only if the double inclusion in 'gross income' would result in double taxation. It operates *ab initio*, at the level of 'gross income', which is the starting point of the tax computation. An agreement to avoid or prevent double taxation need not be confined to therapeutic measures but may include prophylactic measures as well.<sup>37</sup> *Brummeria*, relied upon by the respondent, is distinguishable because two separate accruals arose in that matter, the right to use money interest-free on the one hand, and interest on the money obtained interest-free on the other hand. In the matter under consideration the accrual of the dividends replaced and eclipsed the contingent right to dividends, so that there was only one accrual.

65. I therefore conclude that the concept of unconditionality forms part and parcel of the very fabric of the Act<sup>38</sup> and that entitlement to a contingent right does not give rise to an accrual as envisaged in the definition of gross income. The question arises how one can be 'entitled' to a contingent right. It is only when such a contingent right is ever sold that gross income can arise in the form of an amount received. In this instance the contingent right, acquired by ABC when the antecedent cession took place, could not have given rise to 'gross income' – because nothing had yet accrued. The right was still contingent. The respondent's suggestion that the appellant acquired an unconditional right to dividends, the subject matter of which was a conditional right to the payment of a dividend and that the right to dividends had a value equal to the dividends, is not persuasive.

66. In respect of section 24J the respondent purported to include the contingent dividend rights in the gross income of the appellant as amounts receivable constituting interest in terms of section 24J, alternatively as an accrual in terms of the definition of 'gross income'. It however bears noting that section 24J(3) gives rise to an inclusion in 'gross income'. It stands to reason

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<sup>37</sup> Counsel for the appellant referred to a *Tax Case with Reference Number 6737* reported in September 2012 in an issue of *The Taxpayer* p174-175, more particularly paragraph 7 and 13 on page 175.

<sup>38</sup> *Golden Dumps* 1993 (4) SA 110 (A) at 118.

that only an amount unconditionally receivable can trigger an inclusion in gross income in terms of section 24J(3) on the basis that it embodies an amount receivable. The contingent right received by ABC could therefore not constitute an amount receivable for the purposes of section 24J of the Act. It was not, at that stage, an amount receivable because there was no unconditional entitlement to any amount.

67. The above conclusion in respect of the contingency of the so-called dividend rights is therefore, in my view, the final answer to the disputes between the parties, because reliance on section 24J cannot trump the finding that the dividend rights are conditional and cannot trigger inclusion in gross income.

68. I am in any event not persuaded by respondents contentions in respect of the interpretation of section 24J for the following reasons:

68.1. The respondent bears the burden of establishing the existence of an 'amount' and by inference also the burden of establishing the existence of either 'the sum of all accrual amounts' or 'an amount determined in accordance with an alternative method', as contemplated in section 24J(3). The respondent has failed to establish the existence of any of these. The claim is simply made that dividend rights constitute an 'amount' as contemplated in the 'gross income' definition, which falls to be taxed as an amount of interest accruing to the appellant under section 24J of the Act.

68.2. The respondent has likewise failed to establish the existence of an amount receivable, *inter alia* because the definition of 'yield to maturity' refers to '*the rate of compound interest per accrual period at which the present value of all amounts payable or receivable in terms of any instrument ... equals the initial amount ...*'.

- 68.3. Although the consideration for the use of money is 'usually in the form of interest', this need not necessarily be the case. The parties are free to stipulate a form of consideration other than interest.<sup>39</sup> It is common cause that the parties in this matter stipulated for dividends. ABC was obliged to pay dividends to its preferent shareholders, and so it made sense for it to earn dividend income. ABC had a practical, commercial need to earn dividends, and this underpins the form of the consideration it sought in terms of the note. I agree that dictionary and other definitions of 'interest' are of little assistance where a lender and a borrower expressly stipulate for the payment of something other than interest, in this case dividends.
- 68.4. In respect of the definition of 'interest' in section 24J(1) it bears noting that interest includes finance charges, discount or premium payable or receivable in terms of or in respect of a financial arrangement. It does not appear as if any of these forms of 'interest' or interest in terms of the common law, is involved in this instance.
- 68.5. Under cross-examination Y explained that in accounting practice certain items are referred to as loans and as interest, and that this was merely a matter of accounting convention and not an indicator of the true nature of such items. In my view, there is therefore little merit in the submission that the appellant's financial statements support the respondent's contentions in respect of interest and loans.
- 68.6. The composite indivisible note was not a loan at common law. It was a *sui generis* investment with a fixed maturity date, carrying a return in the form of

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<sup>39</sup> See *Commissioner for Inland Revenue v Standard Bank of SA Ltd* 1985 (4) SA 485 at 494F; *Stone v Secretary for Inland Revenue* 1974 (3) SA 584 (A) at 595-6 and *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* 1946 AD 441 at 451.

dividends. But even if it were to be treated as a loan, this does not make the *quid pro quo* interest where the parties have expressly stipulated a different type of return.

68.7. It is important to note that this is not a case in which SARS contends that the substance of the agreement differs from its form. Thus the express terms of the master investment agreement must be accepted as reflecting the true purpose of the parties; and that purpose was to provide ABC with dividends, not some other right and not interest.

68.8. In the absence of agreement between D Bank and ABC to pay interest, and indeed in the presence of the agreement between them, in terms of which ABC contracted for a 'return in the form of dividends' and D Bank made available to ABC the machinery whereby dividends would accrue to ABC, the artificiality of the reliance by SARS on section 24J becomes manifest.

69. For all the reasons set out above, I conclude that the appeal must succeed and the additional assessments set aside.

70. Both the accountant and commercial member of this court agree with the foregoing analysis of the facts and their effect.

## **COSTS**

71. Section 130(1)(a) of the TAA provides that:

'The tax court may, in dealing with an appeal under this Chapter and on application by an aggrieved party, grant an order for costs in favour of the party, if—

- (a) the SARS grounds of assessment or 'decision' are held to be unreasonable; ...'.

72. In my view SARS's grounds of assessment in this appeal were unreasonable if the background facts referred to above are taken into consideration. This is especially so because it ran counter to the manner in which dividend cession transactions had been routinely assessed over a long period of time. The very issues which SARS raise in this appeal as the basis for the assessment had been expressly considered by the Commissioner's office on numerous occasions and had not given rise to any different tax treatment. The fact that SARS and the National Treasury have taken steps to have the Act amended is also a relevant consideration. In the exercise of the discretion in this respect I therefore conclude that the respondent should pay the appellant's costs of appeal. I believe that an order including the costs of two counsel is justified.

73. It is not necessary to deal with the wasted costs occasioned by the two interlocutory applications brought by ABC in this matter, as in both cases SARS withdrew its opposition to such applications and tendered ABC's wasted costs.

## **CONCLUSION**

74. In all the circumstances the order annexed hereto is made.

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**W.H. VAN STADEN**  
**Acting Judge of the High Court**