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TAX ALERT

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The South African common law, read with the Superior Courts Act, No 10 of 2013 (the Superior Courts Act), provides for the rules pertaining to the attachment to either found or confirm jurisdiction in South Africa. The attachment of property to found or confirm jurisdiction is regarded as an extraordinary remedy and, according to case law, should be granted with caution.

ENERGY SECTOR LICENSE AND CONSENT CHARGES: CAPITAL OR REVENUE?

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VALIDITY OF ATTACHMENT OF SHARES TO FOUND OR CONFIRM JURISDICTION

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The South African common law, read with the Superior Courts Act, No 10 of 2013 (the Superior Courts Act), provides for the rules pertaining to the attachment to either found or confirm jurisdiction in South Africa. The attachment of property to found or confirm jurisdiction is regarded as an extraordinary remedy and, according to case law, should be granted with caution.

Section 28 of the Superior Courts Act further prohibits the attachment of property against a person who is a resident in South Africa in order to found jurisdiction. However, the common law provides for the attachment of the property of a person who is not a resident, whether such property is immovable, movable or incorporeal (such as shares).

This brings us to the recent High Court decision of *Gavin Cecil Gainsford NO (Joint Trustees of Tannenbaum Estate) (Case Number 55517/2014)*, which was handed down on 26 August 2015. The case arose after the High Court in Pretoria granted to the South African Revenue Service (SARS) a provisional order in terms of s163 of the Tax Administration Act, No 28 of 2011 on an *ex parte* basis and *in camera* for the preservation of certain assets belonging to Dean Rees (Rees) and Doggered Investments (Pty) Ltd (Doggered) (the Preservation Order).

The alleged debt owed to SARS was stated to be the amount of R194,423,966.69 and SARS therefore sought to preserve the assets to secure this debt. It was argued that Doggered was Rees' alter ego and therefore SARS also sought to preserve the assets of Doggered to secure the debt. Pursuant to the Preservation Order, the curator *bonis* took control and possession of the assets, *inter alia* the 322 shares owned by Doggered in Promac Paints (Pty) Ltd (Promac) (the Shares).

The issue considered by the Court was therefore whether the Shares were validly attached to found jurisdiction. Pursuant to obtaining the Attachment Order, the Trustees had instructed the Sheriff to attach the Shares.

The joint trustees of the insolvent estate of B.D. Tannenbaum (the Trustees) instituted the application in question in the High Court for an order excluding the Shares from the operation of the Preservation Order, and discharging the Preservation Order in respect thereof on the basis that the Sheriff had already attached the Shares in August 2011. The latter attachment occurred pursuant to an order obtained by the Trustees in July 2011 to found or confirm jurisdiction in their action against Rees and Doggered (the Attachment Order).

The main issue in this instance was, if the Preservation Order was not discharged and if the Court found that SARS established that Doggered was Rees' alter ego, whether the Trustees had attached the Shares in August 2011 in terms of the Attachment Order. It was submitted by the Trustees that, if this was the case, the curator *bonis* was not entitled to take possession and control of the Shares in terms of the Preservation Order.

The issue considered by the Court was therefore whether the Shares were validly attached to found jurisdiction. Pursuant to obtaining the Attachment Order, the Trustees had instructed the Sheriff to attach the Shares. The Attachment Order specifically authorised the Sheriff to do so at the address specified in the Attachment Order. The Sheriff attended at the specified address and allegedly attached

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VALIDITY OF ATTACHMENT OF SHARES TO FOUND OR CONFIRM JURISDICTION

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The Trustees, Promac and Doggered acknowledged that the Shares were attached, however, SARS and the curator bonis contended that the attachment was not proper or lawful as it did not take place at the situs of the share register or share certificates

Even though the right was incorporeal, some document or similar item representing the right had to be attached. In addition, the share certificates or share register had not been kept at the address where notice of the attachment was given. SARS agreed with this argument.

the Shares by notifying Promac of the Attachment Order, and issued the notice of attachment.

The Trustees, Promac and Doggered acknowledged that the Shares were attached, however, SARS and the curator *bonis* contended that the attachment was not proper or lawful as it did not take place at the *situs* of the share register or share certificates, and because the Sheriff did not take the certificates into his possession or cause an entry to be made into Promac's share register. The Trustees argued that there was no such requirement in the Uniform Rules of Court and that the essential requirement for the attachment of shares in a company for the purpose of founding or confirming jurisdiction was that notice of the attachment must be given to the company. It was common cause that such notice was given by the Sheriff.

The curator *bonis* argued that Rule 45(8) applied in the instance and that attachment could only be complete once the Sheriff had given notice of the attachment in writing to all interested parties and had taken possession of the share certificates, or had certified that he could not locate them despite a diligent search. It was further argued that the attachment of incorporeal property required the Sheriff to attach the document evidencing such rights – an incorporeal moveable asset could not be attached merely by the intention or decision of the Sheriff. Even though the right was incorporeal, some document or similar item representing the right had to be attached. In addition, the share certificates or share register had not been kept at the address where notice of the attachment was given. SARS agreed with this argument.

It was argued on behalf of the Trustees that Rule 45(8) only applies to execution proceedings and that all that was required to found jurisdiction was written notice to all interested parties, and that this had been given. It was agreed that physical possession of the share certificates had not been proven but that this was unnecessary.

The Court disagreed with the argument that Rule 45(8) applied in the instance, however, the Court also disagreed with the argument presented by the Trustees that no actual possession of the relevant property was required in attachment proceedings to found or confirm jurisdiction. The Court held that, having regard to the purpose of attachment and the requirements of the common law, an actual attachment is required to found or confirm jurisdiction. There must be the element of possession or control present, and it was common cause that this did not occur in this case.

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ENERGY SECTOR LICENSE AND CONSENT CHARGES: CAPITAL OR REVENUE?

In those countries – like in South Africa – taxpayers may generally not deduct costs of a capital nature for purposes of income tax

Recently two interesting cases were reported in New Zealand and Australia. The cases related to whether certain expenses incurred by taxpayers in the energy sector were deductible for purposes of income tax. In those countries – like in South Africa – taxpayers may generally not deduct costs of a capital nature for purposes of income tax.

In the case of *Commissioner of Inland Revenue v Trustpower Ltd* [2015] NZCA 253 the taxpayer (Trustpower) generated and sold electricity. The taxpayer was developing new projects. In that process it incurred expenses in applying for and obtaining consents under the Resource Management Act 1991. The consents related to land use, water and discharge.

Under New Zealand tax legislation a person "is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature".

The court considered a number of cases and held that the expenditure was of a capital nature and hence not deductible by the taxpayer. Among other reasons for that conclusion, the court found that the costs were incurred to enable the taxpayer to extend or expand its electricity generation business. The court said: "From a practical and business point of view, the expenditure was calculated to effect the extension or expansion of Trustpower's business structure."

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The court also found that the expenses were not incurred in carrying on Trustpower's business or in earning the income of the existing business or in performing the income-earning operations of the existing business.

In the High Court of Australia case of *AusNet Transmission Group Pty Ltd v The Commissioner of Taxation of the Commonwealth of Australia* [2015] HCA 25 the facts were the following. In 1997 a State-owned electricity transmission company sold its assets to the taxpayer (AusNet). One of the assets was a transmission licence. Under the sale agreement AusNet also undertook to pay certain statutory charges pertaining to that licence.

Australian tax law does not allow a taxpayer to deduct an outgoing of capital, or of a capital nature. The court carefully considered previous court judgments, the legislative framework behind the licence charges, and the sale agreement. The court found that the assumption by AusNet of the liability to pay the charges by operation of law on the transfer of the licence to it, and the contractual promise to pay the charges was an integral part of the consideration it had to provide to acquire the assets of the transmission business. The finding was made despite the fact that the purchase price in the sale agreement did not include the charges, and despite the fact that the charges were recurrent.

The court also held that AusNet paid the charges to secure the rights and to carry on the business of the distribution and transmission of electricity.

It was found that the licence charges were of a capital nature and hence not deductible for purposes of the taxpayer's income tax.

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Similarly the cost of obtaining State consents for undertaking an electricity generating plant (as in the Trustpower case) would be seen to be of a capital nature.

In South Africa there still exists uncertainty as the tax treatment of the assumption of contingent liabilities in the hands of a buyer of business assets.

In South Africa, generally speaking, a once-off licence fee is seen as an expense of a capital nature, while a recurring licence fee is of a revenue nature. For example, in *ITC 1726* 64 SATC 236 the taxpayer paid an initial fee for a licence to conduct a cellular service, which was paid before its commercial operations started, and an ongoing annual licence. The court held that the initial payment was an expense of a capital nature as it was incurred for a right that gave the taxpayer an enduring benefit, and as it was more closely connected with the income-earning structure of the appellant than its income-earning operations. However, the court found that the ongoing annual licence fee was recurrent expenditure paid to maintain the advantage acquired by the initial payment and, accordingly, was of a revenue nature.

Similarly the cost of obtaining State consents for undertaking an electricity generating plant (as in the *Trustpower* case) would be seen to be of a capital nature. See for example *ITC 1241* 37 SATC 300 (C) where a court held that expenditure incurred by the taxpayer in attempting to persuade the State to rezone land was expenditure of a capital nature, because the purpose of that expenditure was to obtain a permanent right to use the land for scrap-yard purposes.

One very interesting aspect of the *AusNet* case was the following. Under the sale agreement the taxpayer agreed to assume liabilities of the seller to certain creditors. The obligations thus assumed were stated to be contingent liabilities. The court held that, despite the fact that the price did not include the charges, the charges –

> "were a significant part of the consideration moving from AusNet for the acquisition of the Assets. The designation of an amount as the Total Purchase Price to be paid to [the seller], as distinct from the licence charges to be paid to the State does not relegate the payment of those charges to some lesser, incidental purpose. From the perspective of AusNet, 'from a practical and business point of view', they were part of the consideration moving from it for the acquisition of the Assets".

In South Africa there still exists uncertainty as to the tax treatment of the assumption of contingent liabilities in the hands of a buyer of business assets. Put simply the question is whether the liabilities so assumed are deductible by the taxpayer when they arise (assuming they are of a revenue nature) or whether they form part of the consideration for the acquisition of the assets, in which case they may not be deductible for income tax purposes. The preliminary view of the South African Revenue Service (SARS) is that the liabilities are not deductible and form part of the price (see the SARS publication *Discussion Paper on the Tax Implications for the Seller and Purchaser in relation to the Assumption of Contingent Liabilities in Part Settlement of the Purchase Price of Assets Acquired as part of a Going Concern*). The judgment in *AusNet* appears to provide some support for that view.

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