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TAX

ALERT

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FORUM SHOPPING – WHO DECIDES ON MATTERS PERTAINING TO THE LEGAL STATUS OF ASSESSMENTS?

The Tax Court is a specialist court specifically equipped to adjudicate on tax-related matters pertaining to the lawfulness and correctness of disputed assessments. Sections 104 to 107 of the Tax Administration Act, No 28 of 2011 (previously s81 to 88 of the Income Tax Act, No 58 of 1962 (Act)) together with the rules of the Tax Court, prescribe the procedures to be followed where a tax assessment is disputed and essentially entrusts the Tax Court with the power to determine the merits of a tax assessment.

In the recent matter of *Medox Limited v The Commissioner for the South African Revenue Service* (49017/11) [2014] ZAGPPHC 98, the North Gauteng High Court was faced with the question of whether the High Court has the necessary jurisdiction to rule on the legal status of income tax assessments.

By way of background, the South African Revenue Service (SARS) raised assessments against the applicant in respect of its 1998 to 2002 and 2004 to 2009 years of assessment, before raising an assessment for the 1997 years of assessment. According to the applicant, certain assessed losses arising from previous years were therefore not properly brought forward and taken into account in determining the applicant's tax liability.

In 2009, the applicant realised that its 1997 (and 2003) returns had not been assessed (and that the losses from previous years were not brought forward) and decided to re-submit the 1997 (and 2003) returns, but it did so only in 2011. However, SARS was not willing to entertain the taxpayer's dissatisfaction.

The applicant subsequently approached the North Gauteng High Court for an order declaring all income tax assessments issued after 1997, null and void. The applicant contended that SARS acted *ultra vires* when issuing the assessments because it failed to take into account the assessed losses as provided for in s20 of the Act.

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SARS opposed the application on the basis that the High Court does not have jurisdiction to entertain the application as the dispute between the applicant and SARS concerned the merits of the income tax assessments. SARS submitted that:

- the applicant never submitted its 1997 return;
- the applicant never objected in terms of the Act against the 1998 assessment for not reflecting the assessed losses;
- the 3 year period, as contemplated in s79 of the Act, had therefore lapsed;
- the assessments in question have therefore become conclusive;
- the applicant was not entitled to approach the High Court for an order declaring the assessments void, without exhausting the internal remedies or the remedies provided for in the Act;
- the Act makes it clear that the lawfulness and the correctness of an assessment must be dealt with by the Tax Court;
- in dealing with the application, the High Court will inevitably have to deal with the merits of the assessment; and
- the relief sought by the applicant is a final order as opposed to an interlocutory order.

The applicant submitted that:

- the Tax Court is a creature of statute and does not have inherent jurisdiction – it only has limited powers as derived from the Act;
- the Act does not confer upon the Tax Court the power to make declaratory orders on the status of income tax assessments; and
- the applicant had no internal remedies available to it because the three year period for objecting has lapsed and the only remedy would be to obtain an order on the validity of the administrative action, either by way of a review or a declaratory order.

Having regard to the submissions made by the parties, the court referred to the provisions of s81of the Act and the rules of the Tax Court: "a taxpayer who is aggrieved by an assessment may object to such an assessment in the manner and under the terms and within the period prescribed by the Act and the rules promulgated in terms of section 107A".

The court further referred to the decision in *Van Zyl NO v Master and Another* 1991 (1) SA 874 (E) where Eksteen J confirmed that the only way in which assessments can be questioned is in the manner provided for in the Act. The Act specifically prescribes the procedure and entrusts the determination of the amount of tax to SARS (by way of objection), and on appeal, to the Tax Court. Eksteen J further confirmed that only the Tax Court can determine whether assessments were correctly made and that there was no intention to usurp that function of the Tax Court.

In the case of *Metcash Trading Ltd v Commissioner, SARS* 2001 (1) SA 1109 (CC) the court held that the Tax Court is a specialist court specifically tooled to deal with disputed tax cases and further found that the High Court has jurisdiction to adjudicate upon tax matters only in circumstances where the relief sought is of an interlocutory nature.

Based on the authorities mentioned above, the court held as follows:

- the lawfulness and correctness of disputed assessments must be dealt with by the Tax Court;
- the role of the High Court is to provide a judge as a member of the specialised Tax Court to hear appeals and not matters of first instance;
- the applicant failed to exhaust its internal remedies when it still had the time to do so and now wanted to circumvent the provisions of the Act by seeking a declaratory order in the High Court;
- the application for an order declaring assessments null and void cannot be entertained without assessing the merits of the case. The merits of the assessments fall within the competency of the Tax Court; and
- once an assessment has been made, the parties thereto are confined to the jurisdiction of the Tax Court and must exercise all their rights in the Tax Court - only once they have failed can the matter be referred to the Supreme Court of Appeal or the Constitutional Court.

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In light of the above, the court held that the High Court does not have the necessary jurisdiction to grant the order sought.

What is clear from the judgement is that courts discourage applications that come down to 'forum shopping' by the parties as it could not have been the legislature's intention to create competing and concurrent forums for the resolution of tax disputes.

Nicole Paulsen

REPURCHASE OF PREFERENCE SHARES

The South African Revenue Service (SARS) recently released an interesting binding class ruling (BCR 44) dealing with the tax consequences of the repurchase of certain non-redeemable, non-participating preference shares.

The applicant was a public company listed on the Johannesburg Stock Exchange (JSE). The applicant issued preference shares to certain persons (the class members).

The shares:

- were issued at a par value;
- were not redeemable;
- were non-participating; and
- confer the right on members to a return of capital on the winding up of the applicant equal to the issue price of the shares.

The applicant decided to repurchase the shares at their current market value (as traded on the JSE). The purchase price would be less than the issue price.

SARS made various rulings in respect of the transaction.

Hybrid equity instruments

Firstly, it was ruled that the preference shares do not constitute 'equity shares' as defined in s1 of the Income Tax Act, No 58 of 1962 (Act).

For a share to be an equity share the holder must have the right to either:

- participate in the profits of the company (by way of dividend) in an unlimited manner; or
- participate in the capital of the company (by way of return of capital eg at winding up) in an unlimited manner.

That is, the share must carry the right to fully participate in either dividends or capital. If the share is restricted in respect of only one, it can still be an equity share. Technically then, a preference share can be an equity share if it is a participating preference share – that is, if the holder either participates in the profits (by way of dividends) in an unlimited manner, or participates in the capital (at liquidation) in an unlimited manner.

In the current instance it appears that the shares were non-participating and on winding up the right to capital is limited to the issue price. They therefore could not constitute 'equity shares'.

Secondly it was ruled that the preference shares would not constitute 'hybrid equity instruments' for purposes of s8E of the Act merely because of the repurchase.

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In terms of paragraph (a) of the definition of 'hybrid equity instrument' in s8E(1) of the Act, a 'hybrid equity instrument' includes any share, other than an equity share, if within a period of three years from the date of issue:

- the issuer of that share is obliged to redeem that share in whole or in part; or
- that share may at the option of the holder be redeemed in whole or in part.

The concern seems to be that, where the repurchase took place within 3 years of the date of issue, the repurchase could be seen as a right or obligation in respect of the redemption of the shares. However, SARS made it clear that such a repurchase alone would not be sufficient.

Thirdly, SARS ruled that any power of the applicant to repurchase the preference shares in terms of the Takeover Regulation Panel requirements or s164 of the Companies Act, No 71 of 2008 (concerning the appraisal rights of dissenting shareholders) will not be seen as an 'obligation' to repurchase or redeem the preference shares for purposes of s8E of the Act.

Capital gains tax

SARS ruled that the repurchase (and subsequent cancellation) of the preference shares would not constitute a disposal of an asset by the applicant for capital gains tax purposes.

It seems clear however that there would be a disposal by the class members, and that a potential capital loss could arise to the extent that the payment in respect of the repurchase does not constitute a dividend but a return of capital.

Securities transfer tax

SARS ruled that the repurchase would constitute a 'transfer' for purposes of the Securities Transfer Tax Act, No 25 of 2007 and that securities transfer tax would be payable by the applicant on the repurchase price.

Dividends tax

SARS also ruled that, to the extent that the repurchase constitutes a dividend (as opposed to a return of capital that reduces the applicant's contributed tax capital), dividends tax may have to be accounted for.

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