TAX

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INTERPRETATION OF EXEMPTION PROVISIONS

The Tax Court gave judgment in the matter of *ABC (Pty) Ltd v Commissioner for the South African Revenue Service* (case number 13512, as yet unreported) on 30 March 2015.

Even though the case concerned secondary tax on companies (STC), which has been replaced by dividends tax, it is interesting to see how the court dealt with the interpretation of an exemption provision.

The South African Revenue Service (SARS) assessed the taxpayer for STC in terms of s64B(2) of the Income Tax Act, No 58 of 1962 (Act) on the basis that certain loans made by the taxpayer were loans as contemplated in s64C(2)(g) of the Act. In terms of s64C(2)(g) of the Act, loans made to shareholders or connected persons in relation to such shareholders, are deemed to be dividends.

The taxpayer was a wholly-owned subsidiary of trust X. The taxpayer was part of a group, and it was a property-owning company as well as a treasury company. Interest-free loans were made to the taxpayer, and the taxpayer in turn made interest-free loans to certain borrowers. The loans made by the taxpayer were the subject of the dispute.

The taxpayer did not dispute that the loans were made to its shareholders or connected persons in relation to its shareholders, but relied on an exemption contained in s64C(4)(bA) of the Act.

Section 64C(4)(bA) provided that there will be no deemed dividend:

"…to the extent of any consideration received by that company in exchange for –

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

(ii) any other benefit granted as contemplated in subsection (2)…"

The court noted that STC was a tax imposed on the dividends distributed by a company, and a dividend is essentially a distribution by a company of its profits. The underlying principle of STC was therefore for the state to share in the profits of a company.

The taxpayer argued that, in extending the loans, it did not distribute any of its profits, but merely acted as a conduit of the incoming loans.

SARS argued that, for the loans to qualify for exemption, the loans had to comply with s64C(4)(d) of the Act, which provided that a loan would be exempt from being deemed a dividend where, *"a rate of interest not less than the official rate of interest …is payable by the shareholder or any connected person in relation to the shareholder…"*

SARS's submission was based on the argument that s64C(4)(d) of the Act dealt specifically with loans, and only loans of this kind qualified for exemption. The other exemption provisions, such as that contained in s64C(4)(bA) of the Act, could not apply because of the application of the maxim *expressio unius est exclusion alterius*: the mention of one matter excludes the other.

However, the court ruled that the maxim could not be relied on in this matter, and that it does not always follow that the mention of one matter excludes all others. The maxim should only be used with great caution. The court held that without clear words to that effect, it could not have been the intention of the legislature that only loans contemplated in s64C(4)(d) could be exempt.

SARS also argued that s64C(4)(dA), on which the taxpayer relied, was not applicable because the loans were interest free and thus no consideration was received by the taxpayer.

However, the court held that due to the nature of the arrangement between the parties, the taxpayer received *quid pro quo* for granting the interest-free loans, being interest-free incoming loans.

It was noted that the use of the taxpayer as a conduit was, according to a witness, rather bizarre. However, the court was quick to point out that SARS did not rely on anything to the effect that there was something sinister about the arrangements, and that *"taxpayers are entitled to arrange their affairs in the manner they wish as long as the confines of the law are respected."* Accordingly, the appeal was upheld and the assessments were set aside.

Heinrich Louw

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DLA CLIFFE DEKKER HOFMEYR

AMENDING A STATEMENT OF GROUNDS OF ASSESSMENT

Judgment was delivered by the Tax Court in the matter between *ABC (Pty) Ltd v Commissioner for SARS* (case number 13238/2008, as yet unreported) on 8 December 2014. The matter concerned, among other things, an application by the South African Revenue Service (SARS) to amend its statement of grounds of assessment.

Rule 13 of the previous rules of the Tax Court and rule 35 of the new rules allow parties to amend their pleadings on application. The question is, however, to what extent the court will allow for such amendments.

In this matter the taxpayer sold its business to a certain XYZ for R1 million. However, XYZ was also granted the option to acquire all the shares in XYZ for R1. Soon thereafter XYZ exercised the option and bought the shares in the taxpayer. By that time the taxpayer had accumulated an assessed loss in excess of R85 million (2003). Subsequently, XYZ sold the business back to the taxpayer. XYZ then sold the shares in the taxpayer to D, who nominated E as the purchaser. E then became the sole shareholder of the taxpayer. Under E's control, the company earned substantial income (2005 to 2008).

Following an audit, SARS disallowed the set-off of the taxpayer's assessed loss in 2003 against the income earned from 2005 to 2008 in terms of s103(2) of the Income Tax Act, No 58 of 1962. The taxpayer objected, which objection was dismissed. The taxpayer then took the decision on appeal.

Section 103(2) essentially provides that SARS may disallow the set-off of an assessed loss if it is satisfied that (i) there had been a change of ownership in the taxpayer; (ii) as a direct or indirect result of the change in ownership, the taxpayer received income in the relevant year; and (iii) the change in shareholding was effected solely or mainly for the purpose of utilising the assessed loss.

The taxpayer argued that at the time of issuing the assessments, SARS relied solely on the first change of ownership (when XYZ acquired all the shares in the taxpayer) and not on the second change of ownership (when XYZ sold the shares in the taxpayer to E).

SARS's statement of grounds of assessment, delivered in terms of rule 10 of the previous rules, did, however, refer to the second change in ownership. Thus, SARS argued that it was also relying on the second change of ownership and that this reference entitled SARS to do so. To emphasise the reliance on the second change of ownership, SARS brought an application to amend its statement of grounds of assessment.

In terms of the new rule 31(3), SARS may not include in its statement of grounds of assessment a ground that "constitutes a novation of the whole of the factual or legal basis of the disputed assessment or which requires the issue of a revised assessment".

The court took the view that the question of what may or may not be contained in the statement of grounds of assessment had to be decided under the previous rules.

The court distinguished between two scenarios:

- Where the appeal concerns objective questions of fact or law; and
- Where the appeal concerns discretionary powers which SARS may exercise once satisfied of certain matters.

An example of the first scenario would be where the taxpayer is disallowed a deduction on the grounds that it was capital, but SARS subsequently changes tack and says that it is disallowed because it was not incurred in the production of income. In these circumstances a change in grounds would be fair, provided that there is sufficient notice before trial and there is 'fair play' between the parties.

In the second scenario, one is not dealing with a situation where the law prescribes that particular results must follow if a certain state of affairs objectively exists. Rather, a result is a consequence of SARS being satisfied of certain matters.

In this matter it was therefore important to ask what matters SARS had been satisfied of when SARS disallowed the setting off of assessed losses.

After considering the assessment letter that SARS issued to the taxpayer, the court concluded that SARS based its grounds on the first change of ownership and not the second, even though there were references to the second change of ownership. Mere reference to the second change in ownership was insufficient. The change of ownership must be linked with the elements on which SARS is satisfied, and in this case only the first change in ownership was so linked.

This conclusion was not only evident from the assessment letter, which was a contemporaneous recording of SARS's reasons, but it was also clear from the taxpayer's objection that the taxpayer understood SARS to have based its decision on the first change of ownership. The statement of grounds of assessment essentially followed the assessment letter, and the focus was clearly on the first change of ownership.

Be that as it may, it was argued that SARS was in any event entitled to depart from its initial grounds of assessment. However, the court referred to ITC 1862 75 SATC 34, in which Desai J held:

"The basic jurisdictional requirement for the exercise of the power is that the Commissioner is 'satisfied' of the various

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requirements. Once the Commissioner reaches the requisite level of satisfaction and exercises the power to determine the tax liability on the strength of such satisfaction, an appeal must of necessity go to whether he was justified in being so satisfied. He must stand or fall by his reasons for exercising the power. If the Commissioner did not make his tax determination on the basis of being 'satisfied' about an alternative scheme, he cannot rely on the alternative when his s103(1) determination is challenged on appeal … "

On this basis too, the court found that SARS couldn't rely on different grounds in the statement of grounds of assessment. Explaining its reasoning, the court noted that:

"if, having assessed on the basis of being satisfied of certain matters, the Commissioner discovers other facts which cause him to be satisfied on other matters, he cannot issue a further assessment based on his new satisfaction. However, it is only upon reaching satisfaction on the new elements that he can then issue a fresh assessment. What he cannot do is support his existing assessment on the basis of matters on which he was not satisfied when he issued that first assessment."

The only solution open to SARS is therefore to issue new assessments, before the matter prescribes. On this basis the court dismissed SARS's application to amend its statement of grounds of assessment.

The court did not express a view on whether SARS might still be successful by solely relying on the first change in ownership of the taxpayer.

Heinrich Louw

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