

SOUTH AFRICA / JUDGMENT

ACB Company (Pty) Ltd and Another v Commission for the South African Revenue Service (0032/2016; 0033/2016) [2017] ZATC 14 (30 June 2017)

[2017] ZATC 14

COURT

Tax Court

BEFORE

Mali

CASE / FILE NUMBER

0032/2016; 0033/2016

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REPUBLIC OF SOUTH AFRICA

IN THE INCOME TAX COURT OF SOUTH AFRICA

HELD IN JOHANNESBURG

Case Numbers: 0032/2016 &

0033/2016

REPORTABLE: NO

OF INTEREST TO OTHER JUDGES: NO

REVISED.

In the application between ACB COMPANY PTY LTD and DEF (PTY) LTD APPLICANTS and THE COMMISSIONER FOR THE SOUTH REVENUE SERVICE RESPONDENT

J U D G M E N T

MALI J

- [1] This matter concerns two identical applications. They have not been consolidated but were set down for hearing together because the same key legal issues arise in both. The parties agreed that the application will be argued with reference to case no 0033/2016, DEF (Pty) Ltd ("DEF"). Since the same process has been followed in both applications the same result in DEF will follow in ABC (Pty) Limited application ("ABC").

- [2] The applicants in both companies are limited liability companies incorporated in terms of the Company Laws of the Republic.
- [3] The respondent is the Commissioner for the South African Revenue Service ("SARS"), appointed in terms of section 6 of the SARS Act No.34 of 1997 ("SARS Act") by the President of the Republic of South Africa, or the Acting Commissioner designated by the Minister in terms of section 7 of the SARS Act.
- [4] The application is in terms of Income Tax Court Rule 52 (2) (a) ("The Rules"). The Rules are promulgated under section 103 of the Tax Administration Act ("TAA"). In terms of Rule 52 (2) (a) a taxpayer may apply to the tax court if SARS fails to provide the reasons under Rule 6 required to enable the taxpayer to formulate an objection under Rule 7, for an order that SARS must provide within the period allowed by the court the reasons regarded by the court as required to enable the taxpayer to formulate the objection.
- [5] On 22 October 2015, SARS issued a section 80 J (1) notice ("notice") to the applicants. SARS issued the notice setting out the audit findings and the basis upon which the Commissioner believed that the General Anti- Avoidance Rule ("GAAR") provisions applied in respect of the arrangements entered into by the applicants.
- [6] The applicant's response to the notice stated the reasons as to why the provisions of GAAR are not applicable to the arrangements entered into by the applicant. The response of the applicant was that they were neither aware of, nor a party to any such transactions and agreements as set out in the notice. In paragraph 3 of the letter of 12 November 2015 the following is stated:
- "3.1 From the outset it should be noted that DEF received the Notice with surprise. Except as indicated, DEF-
- 3.1.1 was not involved in "Project OHM" and bears no knowledge of same;
- 3.1.2 was not aware of the participation in any other company in the transaction as described in the Notice;
- 3.1.3 was not party to any such agreements;
- 3.1.4 was never involved in or made aware of discussions pertaining to such agreements;
- 3.1.5 cannot comment on the commercial rationale for any such agreement; and
- 3.1.6 did not participate in any profit sharing or tax sharing arrangement."
- [7] In fact in the letter referred to above the response to SARS extends to paragraph 8 and Annexure "A". On 19 November 2015 SARS requested additional information from the applicant. On 26 November 2015 the applicant respondent to the request of SARS by furnishing the required additional information.

[8] On 16 May 2016 SARS issued additional assessments to the applicant. The assessments were raised through the application of GAAR; Sections 80 A-L of the Act. At page 2 paragraph 5 of the assessment letter ("assessment") it is stated that "based on the audit findings, the following adjustments have been made to your assessment." The adjustments relevant to the applicant were described in the table inserted at page 3 of the assessment. The following is stated:

"exempt dividend income re-characterised as taxable income."

[9] In paragraph 81 of the assessment letter SARS stated the following:

"..... each ' arrangement' includes the following:

81.1 The subscriptions by DEF for the respective ACME preference shares and the dividends arising thereon;

81.1 All transactions involved in the tax benefit leg; and

81.3 The investment by ACME into the underlying paper and the interest arising thereon".

[10] Quite clearly the applicant was aggrieved by the respondent's additional assessments. As a result on 1 June 2016 the applicant requested the respondent to provide reasons for the additional assessments in terms of Rule 6(1). The applicant's motive for the request of reasons was to formulate an objection as prescribed in Rule

7. The requests in paragraphs 6.3 to 6.6 sought to identify the "transaction, operation, scheme, agreement or understanding" which was included in each "arrangement" relied on by SARS in the assessment.

[11] The request in paragraph 6.7.1 sought to establish the basis on which SARS contends that each relevant "arrangement" satisfied the "abnormality" requirement of an impermissible tax avoidance arrangement (ie which of the bases referred to in paragraphs (a) or (c) of section 80A SARS relies on in contending that each relevant "

arrangement" was abnormal or tainted).

[12] The response to the applicant's aforementioned request is contained in a letter dated 7 June 2016. The relevant part of the letter reads as follows:

"2. SARS is satisfied that the letter of assessment dated 16 May 2016 contains sufficiently detailed reasons for additional assessment. Specifically, the information requested in paragraphs 6.3 to 6.7 of your letter of 1 June 2016 is set out in our aforementioned letter in clear and detailed fashion.

3. With respect to paragraph 6.8 of your letter, SARS asserts that:

3.1 The 'requirement' made of SARS is not a valid request for reasons in terms of Rule 6, as it has no bearing on the assessments made in respect of ABC; and

3.2 SARS is in event (sic) neither 'required ' nor able to disclose such details to ABC.

4. This letter serves as the notification provided for in Rule 6 (4) of the Rules.

THE STATUTORY FRAMEWORK

[13] Rule 6(1) provides that a taxpayer who is aggrieved by an assessment may, prior to lodging an objection under rule 7, request SARS to provide reasons for the assessment required to enable the taxpayer to formulate an objection in the form and manner referred to in Rule 7.

[14] Rule 6 (4) provides that where a SARS official is satisfied that the reasons required to enable the taxpayer to formulate an objection have been provided, SARS must , within 30 days after delivery of the request, notify the taxpayer accordingly, which notice must refer to the documents wherein the reasons were provided.

[15] Rule 7 provides as follows:

"(1) A taxpayer who may object to an assessment under section 104 of the Act, must deliver a notice of objection in the manner set out under subrule (2) within 30 days after;

- (a) the delivery of the reasons requested under rule 6(4); or
- (b) where the taxpayer has not requested reasons, the date of assessment.

(2) A taxpayer who lodges an objection to an assessment must

- (a) complete the prescribed form in full;
- (b) specify the grounds of the objection in detail including -
 - (i) the part or specific amount of the disputed assessment objected to;
 - (ii) which of the grounds of assessment are disputed; and

(iii) the documents required to substantiate the grounds of objection that the taxpayer has not previously delivered to SARS for purposes of the disputed assessment.

(c) ...;

(d) ...; and

(e) ...

(4) Where a taxpayer delivers an objection that does not comply with the requirements of subrule (2), SARS may regard the objection as invalid and, if SARS is in possession of the current address of the taxpayer, notify the taxpayer accordingly with 30 days of the receipt of the invalid objection."

- [16] Section 80B of the Act provides the Commissioner with a discretion to determine the tax consequences of any impermissible avoidance arrangement. Section 80A of the Act provides for the definition of impermissible avoidance arrangement whose main purpose must have been to obtain a tax benefit and must result in a tax benefit.
- [17] The applicant contends that the respondent's letter of 7 June 2016 is tantamount to refusal to provide the reasons as requested. Information required is necessitated by the legal requirement pertaining to the formulation of the objection. To the above contention it is submitted on behalf of the respondent that the response of the Commissioner of 7 June 2016 is not a refusal to grant reasons. The Commissioner is satisfied that the reasons required to enable the taxpayer to formulate objection have been provided in terms of Rule 6 (4).
- [18] In developing his argument that the Commissioner's reasons were inadequate, counsel for the applicant submitted that it is crucial for the applicant to know precisely what the grounds or reasons for the assessment are so that it can properly formulate its objection. Counsel supported his argument by stating that the request for reasons constitutes administrative action, therefore is consistent with the requirements of section 33 of the Constitution. Section 33 of the Constitution provides that everyone has a right to administrative action that is lawful, reasonable and procedurally fair and that everyone whose rights have been adversely affected by administrative action has the right to be given written reasons.
- [19] It is further submitted that it is crucial for the applicant that it obtains clear reasons to avoid potential prejudice attendant upon it when filing for objection as provided for in Rule 34. Rule 34 only allows for the grounds stated in the objection, the taxpayer cannot raise new grounds in its appeal. There will be no other opportunity for the applicant to present its case in the event the applicant needs to proceed on appeal.
- [20] The applicant contends that it is entitled to adequate reasons. In this regard the court is referred to Minister of Environmental Affairs and Tourism v Phambili Fisheries^[1] ("Phambili"). The applicant further contended that it is not challenging the merits of the case as was the position in Commissioner for SARS v Sprigg Investment 117 CC^[2].
- [21] Regarding the applicant's contention that it will not have another opportunity to present its case if the matter proceeds on appeal; it is apposite to summarise the procedure in dealing with tax matters. Subsequent to Rule 31 statement setting out a clear and concise grounds of disputed assessments and stating the material facts and legal grounds of opposing the appeal a Rule 32 statement should follow.

- [22] Rule 32 statement is a taxpayer's statement setting out a clear and concise statement of the grounds upon which the taxpayer appeal, stating the material facts and legal grounds upon which he relies for such appeal and stating which of the findings and legal grounds are alleged in the Rule 31 statement are admitted and which are opposed. The Commissioner may reply to the rule 32 statement, thereafter the matter proceeds to preparation for appeal hearing, a hearing akin to trial.
- [23] The preparation for appeal or trial allows for discovery of documents, expert summaries, pre-trial conference; and request for further particulars. Having summarised the procedure it is apparent that a taxpayer is afforded an opportunity to request further particulars.
- [24] Counsel for the respondent submitted that the applicant must read the letter of assessment with previous correspondence as held in Sprigg. At page 9 the following is stated:
- "[16] It will be recalled that the letter of findings formed the basis of the assessments which, as previously indicated, incorporated the reasoning it contained. Notably, the respondent did not, at that stage, complain about the quality of SARS' factual findings or that it did not understand why they had been made. What it did instead, as Fyfe properly acknowledged, was reply in fine detail as to why it disagreed with the reasoning and findings and clearly had no difficulty responding to them"
- [25] The above brings the court to the analysis of the applicant's request in the context of Sprigg. Despite the applicant not having 97 questions as in Sprigg it appears that there are significant similarities with Sprigg. The taxpayer in Sprigg, in response to the letter of audit findings, submitted a detailed response in which it denied the main conclusions reached by SARS. Subsequent to SARS raising assessments, Sprigg requested the Commissioner to furnish the reasons for the assessment.
- [26] The Sprigg pattern is found in the present matter, in that the applicant responded to the Notice, and that was not the end of the matter. When SARS requested additional information to the applicant's response, the applicant went into great lengths providing the information.
- [27] In the applicant's letter of 26 November 2015 read with its response to the Notice it is apparent that the applicant clearly understood the arrangements referred to and all transactions referred to in the tax benefit leg. In the abovementioned letter the applicant seems to put the blame on the ZYX Bank of South Africa ("ZYX"). The applicant even mentioned the ACME Group and other groups like UTOPIA.
- [28] The principle established in Phambili is that the party whom the decision has been taken against, must be given adequate reasons that will make the party to understand why the decision went against it, even it does not agree with the decision.

[29] Phambili further establishes that the decision-maker is required to set out his understanding of the relevant law, the findings of fact on which his conclusions depend, and the reasoning process which led him to his conclusions. Reasons should be properly informative. They must explain why the decision was taken.

[30] I now turn to enquire whether SARS's decision meets the Phambili test.

31.1 Understanding of the relevant law:

In respect of the years of assessment at page 24 of the assessment letter titled "FINALISATION OF AUDIT: PROJECT OHM ("assessment letter") under Income Tax and STC findings SARS has clearly displayed that the charging provision is section 80B. SARS's understanding of the relevant law is clearly set out.

31.2 Findings of fact on which the conclusions depend:

In paragraph 4 and 5 at page 2 of the assessment letter the following is stated:

"4. Despite the contents of the Letter of Findings ("LOF") Response, we are not dissuaded from our findings as set out in the LOF. We reiterate herein our analysis and grounds of assessment as set out in the LOF and include rebuttals to the LOF Response.

5. Based on the audit findings, the following adjustments have been made to your assessments."

[31] From the above it is apparent that the facts are contained in the LOF and its response. The facts are repeated in the letter of assessment from page 4 to 10. In summary they are; DEF and ABC advanced R600 million and R1 billion respectively to two entities in the ACME group of companies, Cat (Pty) Ltd and Dog (Pty) Ltd ("the ACME entities") . The investment in these shares generated a tax-exempt dividend yield that conferred Secondary Tax on Companies (STC) credits.

[32] The R1.6 billion was ultimately invested by ACME, through a series of transactions, in interest-bearing linked notes ("CLNs") issued by ZYX Bank. In the normal course, if the taxpayer's money was invested with ZYX Bank by way of CLNs, the taxpayer would receive a taxable interest payments as a return on that investment. If the taxpayer wished to distribute the profit in the form of the interest earned to shareholders, it would have to pay STC on the dividends paid to its shareholders.

[33] The interposition of the ACME and UTOPIA entities, and the transactions that occurred among them the taxable interest paid by ZYX Bank and deducted by it, passed back to the taxpayer in the form of tax exempt dividends that conferred STC benefits on the taxpayer. The intervening transactions created income tax (in that taxable interest was not taxable) and STC benefits (in that the taxpayer did not pay STC when it was supposed to be triggered by the event of declaring dividends to its shareholders from the interest income from ZYX Bank).

- [34] In applying the law into facts SARS has clearly reached a conclusion that in respect of Income Tax, exempt dividends income has been re- characterised as taxable interest income in respect of all the years of assessment. In respect of STC, dividends received from net amount were reversed.
- [35] The pedantic questions as to who is ACME; who is DEF ; who is the party; what is collectively and interchangeably, which subscriptions are referred to etc; are clearly understood by the applicant. This can be seen in its letter of 26 November 2015, for example in paragraph 5, there is a mention of ACME Group of Companies, DEF Companies. It is therefore reasonable to believe that both the applicant and the respondent are referring to the same thing.
- [36] The sudden misunderstanding or lack of adequate reasons is baffling. It appears that the applicant seeks clarity or reasons to what it has already answered as quoted in paragraph 6 above. In my view the applicant's request is a delaying tactic.
- [37] Having regard to the above I find nothing more to be done by the respondent to satisfy the applicant. The respondent has satisfied the Phambili requirements. My view is that the applicant will not be prejudiced in formulating its objection against SARS assessment letter.

COSTS

- [38] The applicant sought an order that in the event it is successful, the respondent should be ordered to pay costs. The costs to include the costs of two counsel. The respondent also sought an order for costs including costs of two counsel.
- [39] Section 130 of the Tax Administration Act ("TAA") provides as follows:
- (1) 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 assessments or 'decision' are held to be unreasonable;
 - (b) the 'appellant's grounds of appeal are held to be unreasonable;
 - (c) the tax board's decision is substantially confirmed;
 - (d) the hearing of the appeal is postponed at the request of the other party; or
 - (e) the appeal is withdrawn or conceded by the other party after the 'registrar' allocates a date of hearing.
- [40] The matter brought before court is an application related to SARS grounds of assessment. As concluded in paragraph 37 above, respondent or SARS grounds of assessment are found to be reasonable. It follows that this is an application which should never have been brought to court.
- [41] In the result, the application is dismissed with costs, including the costs of two counsel.

N.P. MALI

JUDGE OF THE HIGH COURT

Counsel for the Applicant: P. Solomon SC with J Boltar Instructed by:Cliff Dekker Hofmeyer Inc.

Counsel for the Respondent: AR Sholto- Douglas SC with H Cassim Instructed by:South African

Revenue Service Date of Hearing: 17 November 2016 Date of Judgment: 30 June 2017

[1] 2003

(6) SA 407 (SCA)

[2] 2011

(4) SA 551 (SCA)

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