

SOUTH AFRICA / JUDGMENT

S G Taxpayer v Commissioner for the South African Revenue Service (IT14264) [2018] ZATC 1; 81 SATC 308 (9 May 2018) [2018] ZATC 1

COURT

Tax Court

BEFORE

J I Cloete, B R Hilliard, T Pasiwe

CASE / FILE NUMBER

IT14264

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Republic

of South Africa

IN THE TAX COURT OF SOUTH AFRICA

(CAPE TOWN)

Case

No: IT 14264

S

G

TAXPAYER Appellant

and

THE

COMMISSIONER FOR THE SOUTH AFRICAN

REVENUE

SERVICE Respondent

Court:

Justice J I Cloete, Mr B R Hilliard (Accountant Member) et Mr
T Pasiwe (Commercial Member)

Heard:

26, 27, 28 February 2018 and 1 March 2018

Delivered:

9 May 2018

JUDGMENT

CLOETE J:

Introduction

[1] The central issue in this matter is whether, as the appellant (“the taxpayer”) contends, there is a sufficiently close connection between the contribution of R48 million^[1] (“the expense”) paid by it to a certain Trust in respect of its own employee management share incentive scheme (“the

scheme”), and its production of income during the 2005 to 2012 years of assessment (“the income”) for purposes of s 11(a) of the Income Tax Act (“ITA”).^[2]

[2] If the taxpayer fails on the central issue, then it is necessary to determine whether the respondent (“SARS”) is precluded from having raised additional assessments for the 2005 to 2009 years in terms of s 99(1) of the Tax Administration Act (“TAA”)^[3] by virtue of the statutory periods for such assessments having elapsed. The parties are ad idem that if the taxpayer succeeds on the central issue, no determination is required in respect of the prescription point.

Background

[3] The taxpayer is one of the S group of companies. It is the group’s chief operating arm and is a wholly owned subsidiary of the group’s holding company (“HoldCo”). During 2004 it was resolved that the taxpayer would adopt and implement a share incentive scheme for its key management personnel.

[4] It is common cause that: (a) the selected employees were all key managerial staff of the taxpayer;

(b) the purpose of the scheme was to incentivise these employees; (c) the contribution of R48 million paid by the taxpayer was for purposes of the scheme;

(d) the employees indeed benefited from the scheme; (e) the contribution was not expenditure of a capital nature^[4]; and (f) the scheme was legitimate and the transactions comprising it were neither simulated nor a sham.

[5] The scheme was structured and implemented as follows. On 30 November 2004 HoldCo established the Trust. It is a discretionary trust and HoldCo was its sole beneficiary until 13 December 2010. The Trust acquired a shelf company (“NewCo”).^[5] The employees were offered ordinary shares in NewCo (“the NewCo shares”) at par value in proportions determined by HoldCo.

- [6] The employees duly paid cash for these shares, and acquired them, when they were issued on 15 December 2004. It was a term of the NewCo shares acquisition[6] that the employees could not deal freely with them prior to the expiration of at least 7 years from date of acquisition (i.e. at the earliest, 15 December 2011). Those employees who left the taxpayer during this period in fact forfeited their shares which were then re-allocated to other eligible employees.
- [7] On 7 December 2004 the Trust[7] and the taxpayer concluded a contribution agreement. Given that the fate of the contribution (of R48 million) was SARS' focus in the subsequent dispute, it is appropriate to quote from certain clauses of that agreement:

‘2. RECITAL

2.1 The Company [i.e. the taxpayer] is the employer of the Eligible Participants as defined in the ... Management Incentive Share Scheme Rules 2004 (“the Rules”).

2.2 The Company wishes to maintain a happy and contented managerial team and, in particular, to incentivise and retain its senior managerial and executive staff who make a key contribution to the business of the ... Group. From a philosophical point of view the Company believes in the alignment of the interests of staff with the interests of shareholders and recognises the importance of long-term equity incentives over and above more traditional short-term forms of remuneration and accordingly wishes to implement a share scheme in the nature of the NewCo Scheme as defined in the Rules.

2.3 Due to certain company law and administrative constraints it has been necessary to establish the Trust in order to implement, where applicable, the provisions of the NewCo Scheme.

2.4 The Company accordingly wishes to appoint the Trust to provide a valuable incentive to the Eligible Participants in the form of an indirect interest in the listed shares of [HoldCo] by implementing the NewCo Scheme in accordance with the Rules.

2.5 In order to enable the Trust to fulfil the purpose set out in clause 4 to do what is required to implement the NewCo Scheme, the Company has agreed to contribute, as a non-refundable expense to the trustees for the time being of the Trust (“the Trustees”), an initial maximum amount of R60 million upon the terms and conditions set out in this agreement...

4. PURPOSE

4.1 The Trustees shall be obliged to apply the initial Contribution, as well as any income or property derived therefrom, to incentivise the Eligible Participants (being the [taxpayer's] employees) in accordance with the import and intent of the NewCo Scheme as more fully appears in the circular to ... Shareholders dated 30 November 2004 and the Rules and any subsequent schemes adopted by the [taxpayer] and the Trust from time to time.

4.2 In furtherance of the aforesaid objective, the parties agree that the Trustees shall be obliged to apply the entire Initial Contribution in subscribing for preference shares in Maxshell 72 Investments (Proprietary) Limited (“NewCo”) as contemplated in the Rules.’

- [8] On 20 December 2004, once NewCo’s share capital was altered to create 1000 preference shares, the Trust subscribed for them by utilising the contribution of R48 million paid to it by the taxpayer. NewCo thereafter applied the funding received from the preference share issue to purchase (not subscribe for) 8 274 043 HoldCo shares at the prevailing market price at that time.
- [9] The preference shares issued to the Trust were only redeemable after 5 years and carried an accumulated annual market-related coupon rate equal to 75% of the South African prime rate.[8] NewCo paid no dividends during the 5-year period. The result was that the taxpayer’s employees, as shareholders of NewCo, became entitled to the incremental value of their shares by virtue of NewCo’s investment in HoldCo.
- [10] Upon expiry of the 5-year period the HoldCo shares had appreciated in value such that the investment (and hence the value of NewCo[9]) significantly exceeded the preference share liability. A resolution was passed by the board of directors of NewCo on 18 December 2009 that the 1 000 preference shares be redeemed for a total consideration of R48 471 714[10]. It was also resolved that dividends accruing on the preference shares from date of issue (18 December 2004) to date of redemption,

amounting to R22 562 254, be paid to the Trust. The redemption of the preference shares and the payment of dividends were settled by transferring the equivalent value of HoldCo shares (6 688 698 shares) to the Trust.[11] In terms of the same resolution, a dividend of R28 627 000 was declared by NewCo.

- [11] Having discharged its preference share redemption obligation to the Trust in this manner, and given that the employees concerned were now the only shareholders, NewCo was at liberty to deal freely with its remaining 1 585 345 HoldCo shares. It disposed of these shares for approximately R16.8 million cash in December 2009. The dividend declared by NewCo of some R28.627 million was paid to the employees as participants in the scheme in accordance with the resolution. In April 2011 a further dividend of R635 000 was similarly declared and paid to them (further dividends were also declared and paid thereafter outside the period of the disputed assessments).
- [12] On 13 December 2010, after early termination of the scheme, its participants were included as beneficiaries of the Trust.[12] Given the manner in which the scheme was structured and implemented, the taxpayer’s contribution of R48 million was not repaid to it by the Trust. The preference share dividends of R22.5 million received by the Trust in December 2009 vested in HoldCo as sole beneficiary. Despite the dividends having vested in HoldCo, the annual financial statements of the Trust for the relevant period reflect that the cash was never actually transferred to HoldCo, and a loan in this amount is reflected as payable to HoldCo. After termination of the scheme NewCo was deregistered on 10 December 2012.

[13] The taxpayer claimed the contribution of R48 million as a deduction against its taxable income in terms of s 11(a) of the ITA. The deduction was spread over the period of the anticipated benefit to be derived (7 tax years from 2005 to 2012) in terms of s 23H of the ITA (“the deductions”).

[14] The deductions claimed were initially allowed by SARS but subsequently, by way of additional assessments raised in 2014 and

2015, disallowed on the basis that:

‘...the expenditure was not incurred in the production of [the taxpayer’s] income in that there is no direct, causal link between the contribution and the production of income.’[13]

[Emphasis supplied].

[15] The essential premise upon which SARS based this conclusion was that:

‘The [taxpayer] made the contribution to the Trust of which... HoldCo was the sole beneficiary... HoldCo was the only party to have benefited directly from the contribution made by the [taxpayer] to the Trust in that it would receive the investment in the NewCo preference shares (the contribution of R48 471 714 and the preference share dividends) at the time when NewCo redeemed the NewCo preference shares, and the Trust distributed the preference share capital and the preference share dividends to its beneficiary... HoldCo. The participants were thus not the beneficiaries of the contribution.’[14]

[16] Although SARS itself alleged that the contribution was paid by the taxpayer as part of its policy to incentivise its key managerial staff ‘so as to enable the Trust to subscribe for preference shares in NewCo’,[15] it was contended that, if the taxpayer’s sole purpose had been to incentivise the participants, then they should have been the beneficiaries of the contribution itself.[16]

[17] SARS only relied on s 11(a) of the ITA in disallowing the deductions.[17] It thus placed no reliance on the “negative test” contained in s 23(g) which provides that:

‘23. Deductions not allowed in determination of taxable income.—No deductions shall in any case be made in respect of the following matters, namely—

...

(g) any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purpose of trade...’

[18] Accordingly the taxpayer is not obliged to show that the contribution was laid out or expended for the purposes of its trade. SARS accepts, by necessary implication, that it was.

The evidence on the central issue

[19] The taxpayer called two witnesses, namely its chief financial officer Ms Ronel Van Dijk, and Mr Alan Field, a tax partner at KPMG.[18] SARS called no witnesses on this issue. It is convenient to deal first with Field's evidence, which was materially unchallenged.

[20] He has 30 years' experience in advising on structuring and implementing schemes of this nature. Although not involved in this particular scheme, the concept was his brainchild. He described the purpose of such a scheme to be that key personnel influence the long-term profits of the entity or group concerned. As he put it, the scheme is designed to ensure that such employees '...don't take those decisions that immediately affect them, but take those long-term profit decisions for the company'.

[21] He explained it thus:

'Now, employees work to improve the profitability of the companies for which they're employed. Those companies then produce the additional profits. Those profits that are produced by the employees that are attracted and retained then ultimately, because they have higher profits, influence the share price. The share price is determined effectively on a multiple in the group, and profits are higher. The share price/PE ratio, price earnings ratio, affects the value of the shares and the employees who are attracted to the group work harder to generate more profits and ultimately the share price [of the shares] which they were given an interest to own... In the longer term they then benefit because they are forced to stay on in the company, work hard and generate the profits, and in the five or seven years for which they stay with the company, they have an interest in getting that share price higher by generating higher profits.'

[22] According to Field, integral to achieving the purpose of such a scheme is to ensure that, as far as reasonably possible, the employees enjoy the benefit of the growth in value of the shares without having to carry the attendant risk of a decrease in share value. It is common practice for trusts to be used as a mechanism for group funding of these schemes, and for the efficient management and administration thereof. However, employees who receive funding directly from a trust to acquire shares as part of a scheme are typically exposed to volatility in the share price. It is for this reason that the design of the present scheme incorporated the use of a trust which funded an SPV[20] – NewCo – to purchase shares (in HoldCo).

[23] On the direct trust-funding scenario, the value of the loan received from the trust to fund the shares acquired is not only constant but increases according to the interest rate applicable to the loan. Where there is a decrease in the share price, the employees are placed in the invidious position of becoming disincentivised and facing potential exposure to insolvency. If the employer were to "bail out" the employees, this has an income tax consequence, and the tax exemption provisions aimed at mitigating such a consequence at the time were simply inadequate.[21]

[24] He also explained that:

‘So now when the shares in the company, the employer company,[22] grow, all of that growth will accrue to the employees just as fast as it would have had the employees themselves owned the shares. But there’s downside protection because there’s volatility that’s trapped in the company. It’s not in the employees’ hands. So there’s protection there.

On the other hand, there’s also less funding costs because it’s a preference share arrangement.

At the end of the share scheme arrangement, just in the same way that the employee would have had to settle a loan, NewCo settles the preference shares[23] and all of the growth other than what is necessary to settle the preference shares... will accrue in the employees’ hands.’[24]

[25] Field accepted that the employees did not benefit directly from the R48 million paid to the Trust, but emphasised that this had never been the purpose of the scheme. The contribution was a funding mechanism only. In paying the contribution it was the taxpayer’s purpose, as chief operating arm of the S group, to incentivise its key management personnel by enabling them to participate indirectly in the growth of HoldCo’s shares:

‘...they work hard in their operating company... and that group’s profits grow and because they’ve got an interest in the shares in the holding company... the share price in the holding company grows, and [consequently] their own shares in that company through their interest, in this case, in NewCo.’[25]

[26] It was also Field’s evidence that the contribution enabled the taxpayer to retain dedicated employees, with an incentive to maintain their allegiance to their employer, and from which they ultimately benefited from the dividends paid to them via the share scheme mechanism.

[27] Van Dijk was one of the eligible employees who participated in the scheme. She testified that the incentive it created contributed significantly to her desire to remain employed, working and travelling the extensive hours that she did. She ultimately benefited materially upon dissolution of the scheme. She also explained that the incentive provided by the scheme changed the mind-set of the participants in their decision-making ‘...where the decisions that will be made will be made with that bigger, call it vision almost, in mind’. [26]

[28] She expressed a similar view to Field, that what drives a company’s performance of its share price in the market is its profit:

‘Well all things being equal and world economics playing game, the driver will be profit and in our case dividends declared. We’re a very dividend rich company and obviously dividends depend on the profits derived during the year.’[27]

[29] Van Dijk described the participants in the scheme as follows:

‘These individuals were regarded as key individuals that not only held important positions and... had important responsibilities in the business, but who we also wanted to retain in the business going forward. They were basically the engine room of [the taxpayer], causing – making all the decisions that resulted in the profits derived by the company.’[28]

[30] As did Field, she accepted that the scheme did not permit the participants to share directly in the actual contribution of

R48 million paid by the taxpayer to the Trust (nor in the preference shares or growth in their value before they were redeemed

by NewCo). Much of Van Dijk's cross-examination centred around these facts, and emphasis was placed on HoldCo's control over that R48 million plus growth thereon via the Trust. However, as with Field, what was not challenged was that the taxpayer's

objective was to incur the expense of the contribution – it being undisputed that the taxpayer was never repaid that contribution – in the production of income.

Discussion

[31] Section 11(a) of the ITA provides inter alia that in the determination of taxable income, a taxpayer is entitled to the deduction of expenditure (save for capital expenditure) actually incurred in the production of income from any trade.

[32] In its rule 31 statement SARS relied on the absence of a 'direct, causal link' between the contribution paid by the taxpayer and its production of income in disallowing the deductions claimed.

[33] During the proceedings it was however accepted on behalf of SARS that this is not the test, which is rather that there must be a sufficiently close connection between the expense and the income in order for the expense to qualify as a deduction for purposes of s 11(a).

[34] What is thus required is an assessment of the closeness of the connection between the expense and the income. Where there is a clear and close causal connection, the assessment should be relatively simple. What is important for present purposes is that the causal connection is not necessarily established by reference only to the incurring of the expense and the initial use to which it is put. It is the purpose of the expenditure – from the taxpayer's perspective – that must be considered, together with what that expenditure actually effects,[29] i.e. causes to happen or brings about.[30]

[35] The meaning of the expression 'in the production of income' was considered in the seminal decision of *Port Elizabeth Electric Tramway Company Limited v CIR*[31] where the court held that:

'Now, at first sight, it would appear that only acts necessary to earn the income and expenditure necessarily attendant upon such acts should be deducted; but this is not so. As pointed out above, businesses are conducted by different persons in different ways. The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income, then the expenditure attendant upon it is deductible...

...what attendant expenses can be deducted? How closely must they be linked to the business operation? Here, in my opinion, all expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it.'

[36] In *CIR v Genn & Co. (Pty) Ltd*[32] the court held (with reference to *Port Elizabeth Tramways*) that:

'If I am right in understanding the words "they must be regarded" as connoting that it would be proper, natural or reasonable to regard the expenses as part of the cost of performing the operation this passage seems to state the approach to such questions correctly. Whether the closeness of the connection would properly, naturally or reasonably lead to such treatment of the expenses must remain dependent on the Court's view of the circumstances of the case before it.'

[37] Also relevant in the context of the present matter is that it is not necessary for the taxpayer to show that the particular item of expenditure produced any part of the income for the given year of assessment. As was held in *Sub-Nigel Ltd v CIR*[33]:

'It seems to me clear on the authorities that the Court is not concerned whether a particular item of expenditure produced any part of the income: what it is concerned with is whether that item of expenditure was incurred for the purpose of earning income...

The whole *raison d'être* of the Company is to earn profits, and in taking out these policies it was endeavouring to maintain its profits by making provision against loss in the event of a fire. Now, was the act entailing the expenditure of the amounts paid by way of premium performed for the purpose of earning income? In my opinion the answer to this question is in the affirmative. The mere fact that no income has actually resulted is, in my view, irrelevant...'[34]

[38] Provided that the taxpayer can show that the purpose of the expense was to produce income, any incidental benefit to a third party or the realisation of other possibilities does not serve to preclude the legitimate deduction of the expense: *CIR v Pick 'n Pay Wholesalers (Pty) Ltd*[35] and *CIR v Pick 'n Pay Employee Share Purchase Trust*.[36]

[39] SARS submits that the facts of the present matter fall squarely within the parameters set by *Solaglass*.[37] There the taxpayer was a wholly owned subsidiary of a listed company, which was also the holding company of a large group. At a stage it was decided that the taxpayer, which was dormant, would be utilised to secure, arrange and monitor funds required by all of the subsidiary companies in the group.

[40] Subsidiary companies needing funds would apply to the taxpayer, who would provide them by way of loans upon which interest was charged. This was later extended to include loans to staff members of companies within the group. Loaned amounts written off as irrecoverable by the taxpayer were claimed as deductions from its income for tax purposes. SARS disallowed the deductions.

[41] The taxpayer in Solaglass argued that it conducted the business of a money-lender (or similar) and that the losses were accordingly those of floating or circulating capital, were therefore of a revenue nature, and were thus deductible in terms of s 11(a). The Appellate Division accepted the taxpayer's argument, but dismissed the appeal on the ground that the losses incurred were hit by the prohibition at the time in s 23(g), because the taxpayer's trading activities were geared towards achieving a dual purpose – to further the interests of the group's subsidiaries and thus of the group itself, and also to make a profit. At that stage s 23(g) precluded the deduction of income 'not wholly or exclusively laid out or expended for purposes of trade'. [38]

[42] One of the principles established in the aforementioned decision was reiterated by the Supreme Court of Appeal in Warner Lambert [39] as follows:

'Money spent by a taxpayer in order to advance the interests of the group of companies to which it belongs is not regarded as expenditure in the production of income. The link between the expenditure and the production of income is too tenuous. This has been firmly established in Solaglass...'[40]

[43] However in the present matter it is not SARS' case that the purpose of the contribution paid by the taxpayer was to further the interests of the S group. On the contrary there is no suggestion of this in the rule 31 statement, where it is clearly alleged that the taxpayer paid the contribution to incentivise and compensate key members of its own staff. Accordingly, the principle established in Solaglass, confirmed in Warner Lambert, and relied upon by SARS during argument, does not assist it.

[44] Warner Lambert is though instructive in other respects. There the taxpayer claimed as deductions both direct expenditure incurred as a result of its obligation to comply with the Sullivan Code (in its capacity as a subsidiary of an American company) as well as expenditure incurred in the furtherance of its attendant social responsibility programme. It was the latter expenditure (referred to in the judgment as the 'second category') that formed the substance of the appeal. The court found as follows:

'[14] The consequences of an act often proclaim its purpose. After all, a person is presumed to have intended the natural consequences of his acts. Nevertheless, a court must look carefully at the evidence. If there is credible evidence about a taxpayer's purpose it is not open to the Court to turn what is in reality a consequence into a purpose and ascribe that to the taxpayer. "In a tax case", says Smalberger JA in *Commissioner for Inland Revenue v Pick 'n Pay Employee Share Purchase Trust* 1992

- (4) SA 39 (A) at 58F-H, “one is not concerned with what possibilities, apart from his actual purpose, the taxpayer foresaw and with which he reconciled himself. One is solely concerned with his object, his aim, his actual purpose.” As Lord Brightman explains in a passage from *Mallalieu's case supra*, (at 1100a):

“An expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage.”

- [15] The evidence for the appellant is to the effect that the purpose of the Sullivan Code expenditure – all the Sullivan Code expenditure, not merely the social responsibility expenditure – was to insure against the risk of losing its treasured subsidiary status. If, therefore, the purpose of the admittedly deductible expenditure and that of the contested expenditure was the same, their tax treatment should also be the same. Both were expended in the production of income or neither was.
- [16] It is true that the link between the appellant's trade and the social responsibility expenditure is not as close and obvious in the second category as in the first, but that does not mean that the connection is too remote.’
- [45] It is trite that a taxpayer may organise its financial affairs in such a way as to pay the least tax permissible, provided that the transaction does not disguise its true purpose of tax evasion or the law. In the present matter SARS has not contended that any of the transactions comprising the scheme were simulated or a sham, or that the parties did not intend that each transaction would have effect according to its tenor. It was also not contended by SARS, either in its rule 31 statement or in cross-examination of the taxpayer's witnesses, that the contribution of R48 million which the taxpayer made to the Trust was made with the primary object or purpose of vesting that money in HoldCo. It was also never suggested that this was a scheme to place a dividend in the hands of HoldCo without paying tax, and in any event, as far as the “deemed dividend” argument advanced by SARS in its rule 31 statement is concerned, it expressly abandoned any reliance on s 64C(2)(a) of the ITA.
- [46] On the evidence, the dominant purpose in the establishment and implementation of the scheme was to protect and enhance the business of the taxpayer and its income, by motivating its key staff to be efficient and productive and remain in the taxpayer's employ. The fact that the incentive offered to, and in fact received by, the employees was the financial benefit that would flow from the success of the taxpayer's business and the growth in the value of the shares in HoldCo, cannot detract, in my view, from a finding that the expenditure was incurred by the taxpayer for the purpose of earning income.
- [47] Put somewhat differently, the purpose of the expenditure was to incentivise the taxpayer's key staff through a scheme which facilitated the acquisition of an indirect investment in the shares of HoldCo for scheme participants. The purpose of such

incentivisation, in turn, was: (a) to encourage these employees to grow or increase the value of their indirect investment in HoldCo by contributing to the success and profitability of the taxpayer's business; (b) to encourage employees with the required skills, knowledge and experience to remain in the taxpayer's employ;

(c) to facilitate, for the taxpayer, the retention of staff members with the skills and experience to maximise the profitability of its business and prevent crucial knowledge and experience being lost to the taxpayer through staff turnover; and (d) thereby to preserve and enhance the income earning capacity of the taxpayer's business.

[48] The contribution paid actually effected this purpose, by providing the necessary funds to the Trust (which lacked significant capital prior to payment of the contribution) to capitalise NewCo. In terms of the Trust Deed and the Contribution Agreement, the contribution could not be utilised for any purpose other than the Trust's preference share subscription in NewCo, which was in turn applied to purchase shares in HoldCo. The preference share funding was similarly limited in terms of the Preference Share Subscription Agreement, and could only be used for purposes of acquiring shares in HoldCo, in alignment with the intention of the taxpayer for the scheme to facilitate indirect investment for participants in HoldCo. NewCo's sole asset was the HoldCo shares, and thus the value of the NewCo shares acquired by the participants of the scheme was pegged to the value of the HoldCo shares.

[49] The mere fact that the taxpayer foresaw that HoldCo would potentially also benefit from the redemption of the NewCo preference shares cannot negate the taxpayer's purpose and intention, which was actually effected by the scheme insofar as the value of the NewCo shares increased significantly, and this benefit, together with the dividends declared by NewCo on the remaining HoldCo shares following the preference share redemption, actually accrued to the scheme participants. The increase in the value of the HoldCo shares is directly attributable to the increase in the turnover and profits of the taxpayer, being the main operating subsidiary of HoldCo.

[50] In addition to Van Dijk's evidence, it is common cause that 26 key staff were participants in the scheme and that only 3 left the taxpayer's employ during the period of the scheme. It is thus not unreasonable to infer that the employees were indeed incentivised. The stated purpose of the scheme was confirmed by the credible evidence of both Field and Van Dijk. That the contribution paid by the taxpayer remains extant under the control of another entity in the group does not detract from the purpose for which that expenditure was incurred by the taxpayer, namely the production of income.

[51] Having regard to all of the foregoing, I am persuaded that the taxpayer has established the existence of a sufficiently close causal link between its expenditure of the contribution and its income producing operation. The other members of the court are in agreement with this conclusion.

Costs

[52] Section 130(1)(a) of the TAA provides inter alia that a tax court may make an order for costs in favour of the successful party if the SARS' grounds of assessment or "decision" is held to be unreasonable. The taxpayer submits that SARS should be ordered to pay its costs.

[53] In the exercise of my discretion I do not believe that such an order is warranted in the particular circumstances of this matter. I do not consider that SARS was necessarily unreasonable in adopting the approach that it did. Each case in matters such as this is very fact specific and this was certainly not a case which lent itself to an easy answer.

[54] In the result the following order is made:

1. The taxpayer's appeal succeeds.
2. The additional assessments raised by SARS for the taxpayer's 2005 to 2012 years of assessment are set aside.
3. No order is made as to costs.

J I CLOETE

[1] The exact amount is R48 471 714.

[2] No 58 of 1962.

[3] No 28 of 2011.

[4] For purposes of the sub-section.

[5] Previously Maxshell 72 Investments (Pty) Ltd.

[6] Clause 1.1 Share Scheme Agreement.

[7] Represented by its first trustees Messrs André Minne and Nils Nyback.

[8] As charged by Nedbank.

[9] The value of 8 274 043 HoldCo shares increased from R48.5 million to R71 million, plus cash arising from dividends and interest of approximately R25 million.

[10] Being the exact amount of the taxpayer's initial contribution to the Trust: see fn 1 above.

[11] Thus carrying a total value of some R72 million, determined by dividing the total outstanding value of the NewCo preference shares

by the 10 day volume weighted average share price of the HoldCo shares for the 10 days immediately preceding the transfer/redemption

date of the preference shares.

[12] Clause 3.1 as read with clause 3.3 of the Deed of Amendment.

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- [13] SARS' rule 31 statement, dossier 1, page 5, para 8.15. SARS abandoned any reliance on s 64C(2)(a) of the ITA.
- [14] SARS' rule 31 statement, Dossier 1, page 5, para 8.16.
- [15] Para 8.8, Dossier 1, p4.
- [16] Para 51, Dossier 1, p21.
- [17] Para 8.15, Dossier 1.
- [18] KPMG were the S group's auditors and advised on the structure and implementation of the scheme.
- [19] Transcript Vol 2 pp204-205.
- [20] Special Purpose Vehicle.
- [21] According to Field, s 10(1)(nE) of the ITA, as it then was, set out specific tax remedies for an employee who had acquired and funded the shares under a direct funding share incentive scheme, which was "under-water". However, the remedial tax provisions contained in that sub-section, which allowed employers to repurchase the shares at cost or cancel the share acquisition, were somewhat restricted and in many instances, despite the "stop-loss" provisions, the commercial requirements of the share scheme or the provisions under that sub-section left the employees in an insolvent position.
- [22] Referring to NewCo.
- [23] Including dividends accrued thereon.
- [24] Transcript Vol 2 pp208-209.
- [25] Transcript Vol 2 p240.
- [26] Transcript Vol 1 p35.
- [27] Transcript Vol 1 p35.
- [28] Transcript Vol 2 p196.
- [29] CIR v Standard Bank of SA Ltd 1985 (4) SA 485 AD esp at 500H-501F.
- [30] 'Effects' as defined in the Concise Oxford English Dictionary.
- [31] 1936 CPD 241 at pp16 and 17-18.
- [32] 1955 (3) SA 293 AD at 299C.
- [33] 1948 (4) SA 580 (A) at 592.

- [34] In the instant matter, the annual financial statements reflect that there was a steady increase in turnover and taxable income in the taxpayer apart from a dip due to prevailing economic factors.
- [35] 1987 (3) SA 453 AD in the minority judgment of Nestadt JA quoting Usher's Wiltshire Brewery Ltd v Bruce (1915) AC 433 at 469-70 - the majority reached a different overall conclusion but Usher remains authority on this particular issue, and the principle was affirmed in ITC 1499 (1989) 53 SATC 266.
- [36] 1992 (4) SA 39 AD at 58F-G.
- [37] Solaglass Finance Co (Pty) Ltd v CIR [1990] ZASCA 157; 1991 (2) SA 257 AD.
- [38] Section 23(g) was amended by s 20(b) of Act 141 of 1992 with effect from 15 July 1992 to its current form.
- [39] Warner Lambert SA (Pty) Ltd v Commissioner, SARS 2003 (5) SA 344 SCA.
- [40] At para [11].

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Prepared on 10 October 2026 · Esheria