REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

HELD AT WESTERN CAPE LOCAL DIVISION, CAPE TOWN

Case NO: 24596

(1)	REPORTABLE: YES/NO
(2)	OF INTEREST TO OTHER JUDGES: YES/NO
(3)	REVISED.

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SIGNATURE DATE

In the matter between:

ABCDE SA PROPRIETARY LIMITED Appellant

and

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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J U D G M E N T

This judgment was handed down electronically by distribution to the parties' legal representatives by email. The date and time that it was handed down is deemed to be 10h00 on 17 September 2021.

Hack, A J

[1] The appellant is a company incorporated and registered in South Africa and a South African taxpayer. It appeals against a decision of the respondent to include the net income, of a company incorporated and registered in the Republic of Ireland, ABCDE Limited (hereinafter referred to as "AB") in the determination of the tax payable by appellant. Appellant owns one hundred percent of the shares in XYZ Limited, which in turn owns all the shares in AB. The appellant is one company, in a large corporate structure, conducting business in the realm of financial investment. At the pinnacle is ABC Limited, a company listed on the Johannesburg Stock Exchange. A detailed analysis of the structure is not necessary.

[2] It is common cause, firstly, that AB is a controlled foreign company in accordance with the South African Income Tax Act, No 58 of 1962 (hereinafter referred to as "the Act"). The relevant provisions of the Act are set out below. Secondly, it is controlled by the appellant by virtue of its ownership of the shares of XYZ Limited who in turn owns the shares in AB. Appellant has the prescribed participation rights in AB. It is equally common cause therefore that AB is a controlled foreign company as defined in the Act.

[3] In terms of the pleadings, it is not disputed that when the appellant submitted its income tax returns for the 2012 year of assessment, it excluded the net income of AB from its taxable income. This was consistent with its returns for 2011 and subsequent returns for the year 2013. In April 2015 the respondent conducted an audit of appellant for the three years of 2011, 2012 and 2013. This action however was triggered by the 2012 tax return. The dates were potentially relevant in regard to prescription. However, the parties agreed to extend the dates which extension continues to date.

[4] On submission of the aforesaid return an automatic assessment was issued by the respondent's electronic administrative system. Thereafter this assessment was manually reviewed, and an audit and additional assessment of the appellant was done by respondent. This imposed a very substantial additional sum of tax. Appellant raised an objection and the respondent reduced the sum, but a significant part of the additional liability remained. Appellant took further issue with the reassessment resulting in this appeal.

[5] The respondent asserts that in terms of section 9D of the Act, the net income of AB had to be included in (attributed to) appellant's income for purposes of taxation. The basis upon which the appellant persist in seeking to excluded from its income the net income of AB is that the appellant is claiming the money is subject to the foreign business establishment exemption (hereinafter referred to merely as "the exemption"). The exemption is granted in terms of subsection 9D(9)(*b*) of the Act. The respondent in its additional assessment included the money as taxable income refuting the claim that it is exempt.

[6] At issue in the determination of this appeal therefore is whether section 9D(9)(*b*) is applicable or not. To make that determination it must be decided whether the business conducted by AB satisfies the terms of the provisions of section 9D(9)(*a*). Arising from that decision further issues flow. If the court dismisses the appeal the question to be determined is whether the respondent is entitled to the penalties which it imposed on the appellant. They are, firstly, an understatement penalty and secondly a provisional tax understatement penalty. Thirdly whether to uphold the imposition by the respondent of interest. A further issue is the respective parties' liabilities for costs.

[7] Subsection 9D of the Act is a lengthy provision with multiple subsections. It has been subject to numerous amendments. I shall not reproduce the entire content thereof save for those portions that are both relevant and in their applicable wording. The provisions that will be referred to herein are contained in the following extract of the act:

> **"9D Net income of controlled foreign companies.—**(1) For the purposes of this section—
>
> **'controlled foreign company'** means—
>
> (*a*) any foreign company where more than 50 per cent of the total participation rights in that foreign company are directly or indirectly held, or more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable, by one or more persons that are residents."[1]

(The further provisions of this definition are not relevant)

> **" 'foreign business establishment'**, in relation to a controlled foreign company, means—
>
> (*a*) a fixed place of business located in a country other than the Republic that is used or will continue to be used for the carrying on of the business of that controlled foreign company for a period of not less than one year, where—
>
> (i) that business is conducted through one or more offices, shops, factories, warehouses or other structures;
>
> (ii) that fixed place of business is suitably staffed with on-site managerial and operational employees of that controlled foreign company who conduct the primary operations of that business;
>
> (iii) that fixed place of business is suitably equipped for conducting the primary operations of that business;
>
> (iv) that fixed place of business has suitable facilities for conducting the primary operations of that business; and

[1] Residents of South Africa.

(v) that fixed place of business is located outside the Republic solely or mainly for a purpose other than the postponement or reduction of any tax imposed by any sphere of government in the Republic:

Provided that for the purposes of determining whether there is a fixed place of business as contemplated in this definition, a controlled foreign company may take into account the utilisation of structures as contemplated in subparagraph (i), employees as contemplated in subparagraph (ii), equipment as contemplated in subparagraph (iii), and facilities as contemplated in subparagraph (iv) of any other company—

(*aa*) if that other company is subject to tax in the country in which the fixed place of business of the controlled foreign company is located by virtue of residence, place of effective management or other criteria of a similar nature;

(*bb*) if that other company forms part of the same group of companies as the controlled foreign company; and

(*cc*) to the extent that the structures, employees, equipment and facilities are located in the same country as the fixed place of business of the controlled foreign company;"

(The further provisions of this definition are not relevant)

"(9) Subject to subsection (9A), in determining the net income of a controlled foreign company in terms of subsection (2A), there must not be taken into account any amount which—

(*a*) .....(*has been deleted*)

(*b*) is attributable to any **foreign business establishment** of that controlled foreign company (whether or not as a result of the disposal or deemed disposal of any assets forming part of that foreign business establishment) and, in determining that amount and whether that amount is attributable to a foreign business establishment-

(i) that foreign business establishment must be treated as if that foreign business establishment were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the controlled foreign company of which the foreign business establishment is a foreign business establishment; and

(ii) that determination must be made as if the amount arose in the context of a transaction, operation, scheme, agreement or understanding that was entered into on the terms and conditions that would have existed had the

parties to that transaction, operation, scheme, agreement or understanding been independent persons dealing at arm's length;"

(The further provisions of are not relevant)

[8] To summarise the issues to be determined in terms of the above extracts from the act. To determine whether the appellant is not liable to pay the additional tax, as it avers, it must prove that the net income of AB are excluded because AB is a foreign business establishment. To determine whether AB is a foreign business establishment the court must be satisfied that it complies with, all, of five requirements. Not necessarily in this order, firstly, its fixed place of business is located outside the Republic of South Africa. Secondly, that the place of business is conducted in a physical structure. Thirdly, that the place of business is suitably staffed. Fourthly, that this place is suitably equipped to conduct the business. Similarly, and fourthly that this place has suitable facilities to conduct the purpose. Fifthly and clearly the most important, that it is located outside the country not for the purpose of postponing or reducing tax imposed in South Africa. The fifth requirement is to a degree dependant on the proof of the second to fourth requirements, being factors the legislature has identified as relevant. The fifth requirement goes to the motive or intention. This requires an analysis and assessment of the other requirements. But in additional it requires an overall determination of whether the express contention of the appellant is the true motive for having set up AB, as opposed to being, not to postpone or reduce the tax liability of the appellant. The appellant is required to proof its case on a balance of probabilities, as required by section 102(1)[2] of the Tax Administration Act, No 28 of 2011.

[9] The appellant presented oral evidence of four witnesses, who in turn referred to a certain parts of a substantial trial bundle of documents filed at court by the appellant with the consent of the respondent. The respondent elected not to lead evidence relying on the pleadings and the onus on the appellant. The appellant's witnesses were extensively cross examined by counsel for the respondent. Heads of argument were provided by both parties which referred to various authorities. Having considered the pleadings, the evidence, the

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[2] **102 Burden of proof.**—(1) A taxpayer bears the burden of proving-

(*a*) that an amount, transaction, event or item is exempt or otherwise not taxable;
(*b*) that an amount or item is deductible or may be set off;
[Para. (b) substituted by s. 23 of Act 13 of 2017 (wef 18 December 2017) .] **This amendment is not relevant to the issues herein.**
(*c*) the rate of tax applicable to a transaction, event, item or class of taxpayer;
(*d*) that an amount qualifies as a reduction of tax payable;
(*e*) that a valuation is correct; or
(*f*) whether a 'decision' that is subject to objection and appeal under a tax Act, is incorrect.

(2) The burden of proving whether an estimate under section 95 is reasonable or the facts on which SARS based the imposition of an understatement penalty under Chapter 16, is upon SARS.

submissions and the authorities I am satisfied that the appellant has successfully proven that it is entitled to the exemption in terms of subsection 9D(9)(*b*) of the Act. It complies with all the requirements. I find therefore, for the reasons that follow, that judgement must be granted in favour of the appellant.

[10] The appellant conducts business in the financial realm. A very simple explanation of its business is that it has customers who give it their money which the appellant in turn uses for the purpose of generating income for its clients. Its source of income for this service consists primarily of fees. The fee is based from time to time on the quantum of assets under management. This methodology is consistent with international practices. In other words it acts as a vehicle or broker to identify, what I shall refer to as opportunities, where funds of its clients can be invested for profit. The opportunities available to an investment company such as appellant, takes various forms such as acquiring assets including immovable property, bank deposits, share or stock purchases, and a variety of other investment schemes. This was described as the assets under management. This can be labelled as the company's investment products. One of those products and central to the issues herein is IDCIF, referred to by the parties and their witnesses and legal representatives as "CIS".

[11] The evidence presented by the appellant is that when the South African financial environment started to normalise at the approaching demise of the apartheid regime, better opportunities presented themselves for South Africans to invest abroad. There was an appetite among South African investor to broaden their previous restrictive investment opportunities. They had been restricted by various means including government restrictions on funds leaving the country, sanctions etc. Investors sought opportunities in particular in Europe and the United Kingdom.

[12] Appellant is part of the ABX Group which was established in 1993, the year before democratic elections were held in South Africa. Detailed evidence was lead regarding the description of appellant, drawn from a transfer pricing report, the business plan and oral evidence. I summarise this to say that part of its business is to solicit funds from investors which it manages in various forms to obtain a profitable return both to pay it a fee and to distribute to the investors. The evidence was that the controlling minds of appellant considered various options to provide more opportunities for its South African Investors. Evidence was lead that at the same period in time, the Republic of Ireland was also experiencing a financial metamorphosis. Appellant's office bearers met with representatives of Irish financial institutions who laid out the advantages of using the Irish financial regime (legislation, infrastructure, knowledge and connections) to create the infrastructure so that it could set up the opportunities it was seeking for its South African investors in both Europe and the United Kingdom. It was submitted, and I accept it as correct, that the Republic of Ireland is in a unique relationship with both Europe and the United Kingdom as a result of its

membership of the European Union and its close history with the other nations comprising the United Kingdom (England, Wales, Scotland and Northern Ireland). There is also an historic connection with the so-called new world, in particular the Americas due to the immigration of Irish Citizen in previous centuries. The appellant identified Irish domiciled collective investment funds as an ideal opportunity for South African Investors.

[13] The unchallenged evidence of appellant was, that to provide South African investors the opportunity to invest in an ICIS a management company had to be incorporated and licenced in Ireland in accordance with its laws. Hence AB was set up in Ireland to, establish, operate and manage ICIS. The submission by the appellant is that it was not possible for appellant to offer it's South African (or for that matter international clients, including emigrants from South Africa living abroad) with the opportunity to investment in ICIS without the existence of AB.

[14] I do not consider it necessary to analyse the evidence of the individual witnesses. They all presented evidence in a cogent manner without contradictions. They made concession were necessary and I find all the witnesses on behalf of the appellant to be honest and credible. Two experts witness that were called by the appellant did not contribute to the determination of the issues. At best they could and did merely confirm the evidence led by the present and former company employees of the appellant and AB. I am of the view however that the appellant led their evidence as a reasonable cautious approach as it was initially told the respondent would be leading evidence of experts.

[15] The parties, as would be expected, are both in agreement about the applicable five conditions that need to be proven in terms of the act. In broad terms there is agreement that the first requirement is satisfied. What is in dispute however are whether the appellant has proven whether it is the primary operations of the business of AB, which are conducted at its office in Dublin, Republic of Ireland? The words primary operations are contained in each of requirements two, three and four. In addition, the parties' dispute whether there has been compliance with the fifth requirement regarding the purpose or motive for which AB was set up, as set out in the fifth requirement. I shall briefly deal with the other elements of each of the second, third and fourth requirements and then address the issue of where AB conducts its primary business. The evidence is that the functions that are performed in the Dublin Office are the conduct of maintaining the licence, making policy decisions and oversight of the entire operations of the company. In analysing the third fourth and fifth requirement I shall refer to these functions merely as the activities in the Dublin office. I shall address the question in due course as to whether that consists of the primary function as required in the act.

[16] The first requirement, that the business is conducted through one or more offices, shops, factories, warehouses or other structures, is a simple matter of fact. It is common cause, which was supported by the evidence, that AB offices are located outside of the Republic of South Africa, in Dublin in the Republic of Ireland. The uncontested evidence was that at all relevant times, AB was registered with the Irish Financial Services Regulatory Authority for authorisation to be an Undertaking for CI and TSMC. This is under the European Communities Regulations of 2003. Furthermore that it was granted an investment management licence, under the European Investment Directive number 93/22/EEC in terms of the Investment Intermediaries Act, of 1995 to be a management company under the Undertaking for CI and TS regulations which were governed by the Central Bank of Ireland. Further that it does have offices in Dublin, Republic of Ireland.

[17] The second requirement that the fixed place of business is suitably staffed with on-site managerial and operational employees of that controlled foreign company contains the further words in dispute, who conduct the primary operations of that business. The evidence was that for most of the relevant time four persons were employed by AB and worked on site to carry out the activities of the company at the offices in Dublin. In summary the activities were directed at complying with the requirements to maintain the licence. This was of a supervisory nature. The four employees were the managing director, two accountants and a compliance officer. Extensive evidence was lead of the daily activities, hours and work executed in the office. I also note that accordingly the uncontested evidence there was a Board of Directors who met quarterly and set the strategies and made policy decision for the company. At the relevant times there were four directors one of which was a member of the office staff. In so far as I find (as set out below) that the primary operations of the business were fund management, I am satisfied that this office was suitably staffed.

[18] The third requirement that fixed place of business is suitably equipped, contains the further words in dispute, for conducting the primary operations of that business. I am satisfied that the uncontroverted evidence was the premises were suitable equipped with office furniture, computers and accessories for the staff to perform their functions at the Dublin office.

[19] The fourth requirement that the fixed place of business has suitable facilities contains the further words in dispute, for conducting the primary operations of that business. Comprehensive and detailed evidence was led that the offices had all the normal facilities, power, water, internet and telephone connections for the staff to perform their functions at the Dublin office.

[20] The fifth requirement is that the fixed place of business is located outside the Republic of South Africa, solely or mainly for a purpose other than the postponement or reduction of any tax imposed by any sphere of government in the Republic. The parties disagree in this regard. The evidence on behalf of the appellant can be summarised, as submitted by its counsel, that no South African tax considerations influenced the decision to set up AB in Ireland. The decision was taking purely on business considerations and tax was not a consideration. As stated, no evidence was led by the respondent on this point or at all. Counsel for the respondent sought to challenge this evidence by cross examination. This was futile and this evidence by the appellants' witnesses was presented in a cogent, forthright and consistent manner. I find it to be proven that there was no motive to gain any tax advantage by setting up AB.

[21] To turn to the question of whether the primary business of AB is conducted at the premises in Dublin, in the Republic of Ireland. It is common cause that when AB sought to obtain its licence as set out in paragraph [16] above, it had two options. It elected the choice of an outsource business model. This has remained the position at all times. Having made the election, it is bound to it. Should it wish to change the model it needs to submit a new application for a licence and provide proof that it had acquired the necessary resources and manpower to perform the previously outsourced functions in Dublin. This did not occur at any stage. It proceeded to outsource four functions of its business.

[22] The investment management was delegated to CI Limited a company registered the United Kingdom. The administration was delegated to JPMHFSI Limited and JPMASI Limited, both companies registered in the Republic of Ireland. The custody of records was delegated to JPMBI PLC registered in the Republic of Ireland. The distribution function was delegated to the appellant and to CI Limited as stated a company registered the United Kingdom. AB retained the function of management.

[23] Respondent contends that that management, is not the primary operation of the business and that the delegated activities, in particular investment management, comprise the primary activities and therefore the AB office in Dublin does not satisfy the second third and fourth requirements as enumerated above. It is therefore necessary to consider the relevant importance and or significance of these five functions in the conduct of the business of AB.

[24] According to the evidence, which I accept, investment management concerns the professional use of clients' (investors') money in terms of the specific schemes mandates and limits. This was also referred to in the evidence as investment management trading activities. This is the day to day use of the money or what was called stock picking, selecting which stocks to buy or sell on a stock exchange. Appellant submits that the actual discretionary

decisions of investment managers play a relatively minor role in the overall picture of fund management. I agree.

[25] There no dispute regarding the further outsourced functions of Administration, Custody and Distribution. They are all incidental or ancillary functions and nothing further needs to be said in that regard. As stated, AB retains the fund management function. According to the evidence this comprises the maintenance of its fund management licence, taking responsibility and doing or ensuring that all things necessary are done to comply with the regulations imposed by the Central Bank of Ireland. Furthermore, to ensure compliance with all the contractual obligations imposed on it as contained in the contracts with the investors. Finally, to supervise or oversee the work being performed by external service providers in terms of their contractual obligations to it and where necessary to take corrective measures in the event of failures or non-compliance.

[26] Respondent contends that the court must consider the terms of the licence granted on 25 October 2007 by the Central Bank of Ireland to AB. It points out that it contains a schedule 1 which sets out the activities which AB is permitted to perform. They restricted AB to only engage in activities it is authorised to do in the management of collective investment schemes. Respondent then contends that a management company is defined in the UCITS regulations of 2011 as a company, the regular business of which, is the management of UCITS in the form of Unit Trust, common contractual funds or investment companies (or any combinations thereof) and includes the functions specified in Schedule 1. Schedule one, is entitled "Functions Included in Activity of Collective Portfolio Management" provides three functions; Investment management, administration (which has nine sub functions) and marketing. Flowing from this the contention by respondent is then, that AB does not perform any of these functions and therefore the work that it does do in its Dublin office is not the conduct of its primary operations as set out in the aforesaid schedule.

[27] In argument, however, before the court, the respondent presented a further contention, based on the above referral to the licence then averring that AB is licensed as an "investment" management company. That the "core" activity of a management company is investment management. Then, the averment is made that investment management is a primary function of AB. As AB outsources the function of investment management it a primary function is therefore not conducted in Dublin and the concluding submission is made the AB's primary function of investment management, in terms of the investment management license, is accordingly not conducted by AB in Ireland. Respondent relied on the evidence of the appellant's witnesses which agreed that the income received by AB was fees which arose from investments. The respondent therefore contends that the primary operation of the company is investment from which it derives its income in the form of fees. Accordingly, so

respondent submits, AB does not meet the requirements to be a foreign business enterprise and the exemption does not apply.

[28] I do not agree with these submissions as they are based on an incorrect analysis of the facts presented in evidence. In my view the correct terminology applicable is the distinction between fund management and investment management. This is consistent with the evidence lead. Paragraph 3.1 of the transfer pricing report, a document referred to by both parties, states: “The fund management function in relation to the Irish Funds within the ABX are performed by AB, who has been appointed as the fund manager to all Irish Funds and is responsible for the overall management of the Irish Funds including, but not limited to the investment management function.” The existence and import of documents is not controversial and nothing further needs to be said other than to re-iterate that ABCDE is referred to in this judgment as AB. While investment management is clearly an important function and should the important functions all be labelled as primary then investment management is one of the primary functions. However, the act clearly used the word primary to refer to the single most important function which is supported by further ancillary functions.

[29] I am satisfied on the evidence before me that the numerous activities performed in Dublin are directed to maintaining the licence and managing the company’s ability to offer the opportunity to invest in ICS. Those activities are properly described as Fund Management. That is something completely different to the day-to-day process of managing the actual investments. Only as long as the licence is maintained can the appellant offer the investment opportunities in ICIS. The other functions are all dependant on this. This is the primary function of AB and this is carried out by the staff and infrastructure in Dublin, Republic of Ireland. The day-to-day decision of where the money should be invested, in other words for example the decision to buy or sell stock is the function of investment management, which is a subsidiary function and that can and is performed elsewhere.

[30] As stated, the fee income of AB is based on the quantum of assets under management. Fees are raised on the amounts invested by individuals and apportioned to various role players and a portion is retained by AB and the balance paid to the appellant. The relevant basis of calculating the fees is on the globular amount under management. Appellant submits, and I agree, that the evidence is that the fee is based on the capital contributed by the investors which occurs before any investment management takes place. Even therefore if raising fees were the primary conduct of the company this would still not be as a result of investment management. Fees are received as a result of the creation and managing of a fund. Investors’ money comprises the assets under management. The fees are not based on the profitability of the investments carried out by each individual person playing a role in the process of investment managing. It is correct, as contended by the respondent that investment performance does have some impact on the quantum of the fee. But I agree with the

submission of appellant that while investment performance is an important part of the overall fund management business, its relative contribution to the funds management fee is limited. As submitted by the appellant it is the confidence that investors place in the fund manager per se in placing its assets with the fund manager that gives rise to the fee, rather than the investment management activity. I agree that this is the correct conclusion to be drawn from the evidence.

[31] In my view the determination of this this matter is founded upon the distinction between the concepts of a fund management company – which describes AB and the concept, investment management, which is one of the functions of a fund management company. AB is not an investment management company it is a Fund Management company – it is a licenced fund management company. The licence states that it licenced to conduct collective portfolio management. One of the functions that are carried out by a fund management company is investment management. In this instance that function is outsourced on contract to others.

[32] Fund management is something different to investment management. To manage a fund is complex multi discipline multi-faceted activity. On the evidence presented this is conducted in the office in Dublin. Investment management is to manage an investment that is to do all things necessary to endeavour to grow the investment. That requires a more limited number of activities. If the investment is in stocks, it requires monitoring the market and issuing buy or sell orders. To give an example, if the investment is in property, it requires rental collection, property maintenance and paying expenditure. Fund management is more complex and requires obtaining and securing the correct licences; ensuring compliance with laws whether statutory, regulatory, professional, or other, such as stock exchange rules etc.; making broad decision where to investment; making decision when and to what amount to distribute profits to investors. The evidence on behalf of the appellant was that delegation was not abdication and that if there was non-compliance by any person to whom activities had been delegated the Dublin office, namely AB always remained responsible. The regulator of the licence would look to AB office for redress and to account for the non-compliance. I accept this evidence as correct.

[33] Without the carrying out (execution) of the management function by AB none of the other functions could lawfully occur, the other functions are entirely dependent on the proper execution by AB of its function as the manager. That is because without the licence to take investments and deposit them into ICIS one of the other functions could occur.

[34] The counsel on behalf of both parties presented submission and authority regarding the interpretation of statutes. Both refer to the principles enunciated in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) and *Tshwane City v Blair Atholl*

Homeowners Association 2019 (3) SA 398 (SCA) and correctly submit that the interpretation of a statute requires that the words used by the legislature are to be read in the context of the statute as a whole having regard to the apparent purpose to which the statute and the specific provision is directed against the background in which the legislation was drafted. In short the words must be given their ordinary meaning, unless this would result in an absurdity. (See: *Smyth v Investec Bank Limited* 2018 (1) SA 494 SCA at paragraph [28]).

[35] In my view this matter does not require any detailed interpretation of the provisions of the act. It requires the application of the facts to the applicable legislature. While section 9 of the Act is lengthy with numerous subsections that require a thorough read to follow and understand. But the relevant portions applicable to this matter are clear, unambiguous and can be applied to the facts. The parties differ as to what is the primary operation of ABs. So only those two words are at issue. They are not vague nor are there contradictory ways that they can interpreted. The court must determine from the facts what constitutes the primary function of AB. Then it is a simple matter of fact if that is conducted in Dublin.

[36] I am therefore satisfied that management performed by AB is the primary operation of the business of AB. To set up and maintain opportunities for customers to invest. Without the opportunities in other words without the existence of a licence to conduct business in making investments into ICIS AB would have no business to conduct and there would be none of the other functions of Investment management, administration, custody or distribution.

[37] To turn to the fifth requirement namely the purpose of creating and operating AB. Both parties gave a detailed summary of the development of our tax legislation in regard to the use of external entities by a South African taxpayer in the generation of income. The primary submission by both parties is that the law was developed to address the creation of foreign entities to avoid tax, by the inclusion of section 9D. This served to curtail a growing tendency of the avoidance of paying tax by a resident taxpayer by the creation of a foreign conduit to hide the true origins of income. The legislature however realised it was it necessary to provide the various exemptions to ensure that a balance is struck between the objective of preventing the deferral or avoidance of tax and potential prejudice to South African taxpayers conducting legitimate businesses abroad. If they are subject to higher taxation they would not be able to fairly compete with other international or locally owned enterprises in foreign countries. With reference to explanatory publications by the national treasury the respondent's counsel correctly described the exemption provision as resolving the issue posed by international law of two diametrically opposed principles of anti-deferral or more accurately tax avoidance and international competitiveness. The mischief which the controlled foreign company provisions seek to address are succinctly explained in *Silke on International Tax,* edited by Bennett and Roelofse at page 73 paragraph 4.1.1 as follows: "The mischief at which the CFC rules are targeted arises in situations where a local taxpayer sets up or acquires existing shares in a

company located in a low tax jurisdiction outside his/her home country. The taxpayer then uses this company to conduct activities that could have been carried on from his/her home country i.e. the sole or primary reason for housing the activities in the foreign company is to avoid tax in the home country on the income they produce."

[38] In this regard the evidence of Mr A and Mr B must be considered. They testified that when the appellant was embarking on the journey to provide foreign investment opportunities to its clients a presentation was made regarding the opportunities in Ireland. Further evidence was given that a well-known tax adviser rendered advice to appellant in particular in regard to whether the Foreign Business Enterprise exemption would be possible. Respondent contended that the evidence was that this advice was contained in a written opinion which had been referred to in a letter from the appellant submitted to the respondent. The opinion of this expert was neither provided to the respondent nor to court. The respondent contends that the failure to produce the opinion suggests that it does not support the claim by the appellant for the exemption. No steps were taken by respondent to enforce delivery of the opinion. I would assume that this was on the ground that it would not have any material relevance to the determination of the issues by the court. That would be a correct view.

[39] In this regard Counsels for the respondent make submission which rely on the respondent's contention that the fifth requirements stated above has not been met. They submit that the court must conclude that the primary business of AB is investment management, this is not done in Ireland and therefore the purpose of the section to prevent tax deferment must be applied to the interpretation of the words conducting the primary business of the company. They rely on the own documents of AB, namely its memorandum of association where the objects of the company are described. They aver that the business of AB based on its own founding documents is one of conducting investments. I disagree. For the reasons stated above I am satisfied that the primary objective of AB is to create investment opportunities for clients. Again, investment management can only come about if the opportunities are not established and maintained. In my view it is not necessary analyse the dictionary definition of the word primary in so far as I am satisfied that the primary business of AB has been established on the evidence to be the creation and sustaining of products or opportunities which then in turn can be marketing managed and administered for the benefit of investors.

[40] I am satisfied that the reason why the appellant acquired an interest in ABs was to create opportunities (products/ICS) for its clients or investors which it could not provide in South Africa. To use the words of Silke cited above, it was not conduct that amounted to housing the activities in the foreign company to avoid tax in the home country on the income they produce. It cannot be said that AB was "illusory or non-substantive business undertakings" as stated in Olivier & Honiball *International Tax: A South African Perspective* at

page 581. I am satisfied that AB, “has economic substance and does not merely exist on paper”; the terminology used by the authors in at page 582.

[41] Appellant referred the court to numerous foreign decisions. Respondent criticised this. Whilst they were interesting, I am not influenced by any of those decision as I am satisfied that the conclusion that I drew from the facts in accordance with the applicable South African law is sufficient for the finding that is made herein. I am satisfied that the appellant has proven that it was not motivated by any desire to avoid paying tax in South Africa by the creation of AB.

[42] As to the issue of costs an award of costs against the respondent can be made in terms of section 130(1)(*a*) of the Tax Administration Act 28 of 2011 should the court find that the grounds of assessment appealed against were unreasonable. The appellant sought such a cost order. The submission is that the respondent was unreasonable as it was at all times aware that the conduct of the business of ABs was on the outsource model, and there was never any basis to contend that AB was established to achieve tax avoidance. In my view the multi-level corporate structure of the appellant and the entire group is very complicated. The business model applied both by appellant and AB is equally complicated. It took many days of events and a very substantial bundle of trial documents to explain these two elements structure and business model. I am satisfied that the decision and conduct of the respondent under these circumstances was not unreasonable.

[43] Accordingly the order I make is:

(a) The appeal is upheld and the additional assessment for the 2012 year of assessment is set aside.

(b) The respondent is directed to issue the appellant with a reduced assessment for its 2012 year of assessment in which no amount is included in appellant’s income under section 9D of the Income Tax Act, No 58 of 1962 pertaining to the income of ABCDE Limited.

(c) Each party shall pay their own costs.

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HACK, A J

Assessors: Ms Y Molefe and Mr E Gouws

Date of judgment : 17 September 2021