IN THE HIGH COURT OF SOUTH AFRICA
(Cape of Good Hope Provincial Division)

Case No. A803/2001

In the appeal between

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **Appellant**

and

ESTATE LATE R F WELCH **Respondent**

JUDGMENT : DELIVERED ON 20 AUGUST 2002

DAVIS J

INTRODUCTION.

Mr R F Welch was divorced from his wife Mrs K J Welch on 25 October 1996. In order to make provision for rehabilitative maintenance of Mrs Welch and to contribute to the maintenance of their minor child Tom, Mr Welch elected to settle certain assets upon the Carom Trust ('the trust'), with a view to generate income for the maintenance of Mrs Welch and Tom .

Mrs Welch accepted this proposal in a consent paper entered into by the parties. The terms of the consent paper were made an order of court on the 25 October 1996 .

Mr Welch ('the deceased') passed away on 16 December 1996 prior to the transfer of the assets to the trust. Subsequently the assets which were specified in the consent paper were transferred to the trust. According to information reflected in the liquidation and distribution account of respondent, the value of the assets transferred to the trust amounted to R3 216 760.

Appellant considered the settlement of these assets upon the trust to be 'a gratuitous disposal of property' which fell within the scope of section 55 of the Income Tax Act 58 of 1962 as amended ('the Act'). Respondent objected to the treatment of this settlement as a donation. Appellant disallowed the objection and respondent appealed to the Special Income Tax Court which allowed the appeal and ordered the assessment to be set aside. Appellant now appeals against the judgment of the Special Income Tax Court.

FACTUAL BACKGROUND.

When the Welchs' were divorced on 25 October 1996,clause two of the consent paper, provided: 'the Plaintiff hereby recognises his legal obligation to pay rehabilitative maintenance to Defendant as well as to contribute towards the maintenance of the party's minor child Tom. In discharge thereof, the Plaintiff hereby elects, and the Defendant hereby accepts that the Plaintiff shall settle certain assets in Trust as per the draft trust deed annexed hereto marked CP1 with the specific intention of providing income as follows:

2.1 In respect of Defendant an amount of R4 500,00 per month for a period of 60 months from date of divorce until Defendant's death or remarriage, whichever shall occur sooner.

2.3 As regards the minor child Tom Christopher Welch, Plaintiff shall until said child attains the age of 21 (twenty-one) years or become self supporting, whichever shall occur sooner, contribute towards said child's maintenance as follows:

2.3.1 By payment of the amount of R1000,00 per month to Defendant, which amount shall increase on the anniversary date of the divorce by a percentage equal to the percentage increase in the urban weighted average of the consumer Price Index.

2.3.2 By payment of all school fees, school uniforms, school books, extra mural

activities, stationary and equipment,

2.3.3 By payment of all medical, dental, pharmaceutical, opthalmological and related medical expenses…

2.3.4 In the event of the minor child showing the necessary aptitude in respect of any course of tertiary education and subject to his applying himself diligently thereto, then in said events, notwithstanding the fact that said child may have attained the age of 21 (twenty-one) years, maintenance payable in respect hereof shall continue until such time as said child has completed such course of tertiary study.

2.3.5 In the event of the Trust being for any reason, unable to meet the aforegoing obligations to Defendant and the minor child or any portion thereof, said obligation shall revert to Plaintiff.'

The trust includes as beneficiaries all children born or to be born of the deceased., (Clause 19(b)(i)) the deceased himself (Clause 19(b)(ii)) and Mrs Welch (Clause.19(b)(iii)). Clause 20 of the trust deed empowers the trustees to'pay or apply the whole or such portion of the net income of the Trust as they in their sole discretion from time to time may determine, to or for the benefit (including, without limiting the generality of the foregoing or the Trustees right to determine the same, for the maintenance, medical expenses, education, support, advancement in life…. and generally for such purposes as may, in the sole and absolute discretion of the Trustees, be considered to be for the benefit or in the interest of the Beneficiary concerned) of all or such one or more of the Beneficiaries ….provided that the trust shall first settle amounts due in terms of the

consent papers…'

Clause 21 provides that the 'capital of the Trust shall be held by the Trustees until the vesting date, whereupon the capital then still held in trust shall vest in and be paid in equal shares to the beneficiaries as defined in clause 19(b)(i) provided that if any beneficiary shall die prior to the vesting date, then the share of capital which would have devolved on him shall vest in and be paid to his descendents by representation per stirpes'

Thus, the capital beneficiaries consist only of the children born or to be born of the deceased and expressly excluded both the deceased and Mrs Welch who are accordingly only income beneficiaries.

The purpose of these arrangements was set out in a letter written by the deceased's attorney and addressed to Mrs Welch on 25 September 1995 in which the following was recorded 'Your present needs therefore relate to the provision of a settlement which will provide you with a reasonable income due regard being had to the many factors which are generally taken into account in such matters. Our client envisages that this would take the form of a cash settlement from which you will derive an income rather than the payment of formal maintenance…'

The consent paper implemented the deceased's intention that the transfer of stated assets to the trust would be effected with the intention of generating income to pay the maintenance obligations as set out in clause 2 of the consent paper and Mrs Welch

accepted it.

The dispute between the parties initially turned on the question of estate duty liability. Respondent claimed that there was a liability for R3 216 760,00 which was owed to the trust in terms of the deceased's divorce agreement. On 23 April 1998 Mr Gillespie, on behalf of appellant, wrote to Mr Gees, an executor in the estate of the deceased as follows:

'In terms of the divorce order the deceased has certain obligations to meet in regard to paying rehabilitative maintain to his ex wife as well as maintenance of his child Tom. It is these obligations that can be regarded as a debt due by the estate and not the full value of the assets settled in the trust. An actuarial calculation must then be carried out to determine the above debts due. The value thus calculated will then form a liability in the deceased's estate. Once the calculation has been completed it can be submitted to this office for approval.'

Further correspondence was exchanged between the parties .On 23 July 1998 Mr Gillespie wrote to Mr Gees suggesting that 'According to my calculations the amount deductible as a liability would be R754,000.. This amount is based on the following calculations:.

'Wife

R4,500 per month for 60 months = R270,000

Child

R1,000 per month for 7 years = R84,000

School Fees = R150,000

Medical = R50,0-00

Tertiary Education = R200,000

Total claim allowable = R754,000'

On 7 January 1999 Mr Gillespie wrote to respondent's advisor Mr Haupt advising that 'After consultation with our head office the view has been taken that the settlement is regarded as a 'gratuitous disposition of property' that falls within the ambit of section 55 of the Income Tax Act. …. As such donation tax will be levied on the full value of the assets transferred less R25,000.'

An assessment was then issued for an amount of donations tax of R797 940 together with outstanding interest. That the present dispute relates only to donations tax is made clear by the letter of objection written by Mr Haupt on 27 October 1999 in which he states:

'I hereby object on behalf of the Estate late Robert Frederick Welch to the donations tax assessment dated 11 May 1999 in the amount of R797 940, plus interest'.

JUDGMENT OF THE COURT *A QUO*.

Foxcroft P held that the reason for the transfer of assets to the trust was to be found in the matrimonial dispute between the Welchs' which gave rise to 'an ongoing obligation to provide maintenance'. Accordingly the transfer of assets to the trust reflected the agreement in the consent paper ' for an amount of money to be set aside in order to

realise enough interest to comply with the obligations…The handing over of the money was something which followed upon a court order and in all probability followed upon a realisation by the person handing over the money by agreement in a court order that he was obliged to do so.' Thus, the transaction was undertaken to discharge a legal obligation rather than constituting a any gratuitous intention.

THE IMPOSITION OF DONATIONS TAX IN THE PRESENT DISPUTE.

Section 54 of the Act provided at the time of this dispute that 'Subject to the provisions of section 56, tax shall be paid for the benefit of the National Revenue Fund to tax (in this Act referred to as donations tax) on the value of any property disposed of (whether directly or indirectly and whether in trust or not) under any donation which took or takes effect on or after 16 March 1988 by any person (in this Part referred to as the donor)who in the case of a person other than a company , is ordinarily resident in the Republic' Section 55(1) defines donation as 'any gratuitous disposal of property including any gratuitous waiver or renunciation of a right.'

Ms Fichardt ,who appeared on behalf of appellant ,submitted that the disposal of the assets to the trust was a gratuitous disposition in that it was not given in exchange for any consideration . She contended that there was no evidence before the court to show that the deceased had received anything in consideration for the transfer of the assets. She also submitted that the disposal of the assets could not be regarded as having been made to discharge of an obligation to pay maintenance. The elimination of an obligation to pay maintenance could not be said to be the **quid pro quo** for the disposal. She sought to

justify this submission by contending that the deceased had not eliminated his obligation to pay maintenance to his ex wife and his minor child Tom . In terms of clause 2.3.5 of the consent paper he remained liable in the event that the trust failed to provide Mrs Welch or Tom with the required income. On this evidential basis Ms Fichardt sought to justify the submission that ,as the deceased had transferred assets to the value of R3 216 760,00 the trust without receiving any consideration in respect thereof, the transfer constituted a gratuitous disposition of property as defined in s55 of the Act. For this reason the court **a quo** had erred in finding 'the essential point in this case is that this is not something which happened out of a motive of liberality. The handing over of the money was something which followed upon a court order.'

Mr Bremridge, who appeared on behalf of the respondent, submitted that the entire dispute turned on the meaning of the phrase 'gratuitous disposition'. Relying upon a judgment of **Scott J** (as he then was) in ITC 1545; 54 SATC 464 (C) ,Mr Bremridge submitted that a disposal of property is not gratuitous unless it was motivated by 'liberality and generosity'. He also referred to the following passage from judgment of **Trollip JA** in **Ovenstone v SIR** 1980 (2) SA 721(A) at 736 H – 737 A: 'In a donation the donor disposes of the property gratuitously out of liberality or generosity, the donee being thereby enriched and donor correspondingly being impoverished, so much that, if the donee gives any consideration at all therefore, it is not a donation.' He submitted that as the settlement in Trust had been made pursuant to a court order in order to satisfy financial obligations to the deceased's ex-wife and his minor son there was insufficient liberality or generosity to justify a conclusion that the transaction fell within the scope of

the definition of donation in terms of section 55.

Mr Bremridge contended that there was no room on the basis of s54 read together with s55 of the Act for the argument that the disposal was gratuitous to the extent that the value received in consideration of the disposal was less than the value of the property which was disposed. If that were the case appellant would then have been required to act within the power granted in terms of the provisions of section 58 of the Act which provides that: 'Where any property has been disposed of for a consideration which, in the opinion of the Commissioner, is not an adequate consideration that property shall for the purposes of this Part be deemed to have been disposed of under a donation: Provided that in the determination of the value of such property a reduction shall be made of an amount equal to the value of the said consideration'.

Respondent's argument can be summarised thus: In a case where some consideration passes from the 'donee' to the 'donor' which is not minimal or illusory so that the transaction can be classified as partly onerous and partly gratuitous, only section 58 of the Act imbues the Commissioner with the authority to levy donations tax on the basis of an apportionment. To the extent that the Commissioner has failed to act in terms of section 58, no apportionment could be applied to an assessment issued in terms of section 54 read together with section 55 of the Act.

He submitted further that the fact that it was necessary to deem a disposal to be a donation where the value received by the recipient exceeded any value transferred by the recipient to the disposer was evidence that a disposal for some consideration could not be considered to be gratuitous in terms of the definition of donation in section 55. Were

the converse to apply and the Commissioner was empowered to treat a disposition as partly of a gratuitous nature in terms of sections 54 and 55 of the Act read together, section 58 would effectively be rendered redundant. Thus, the definition of donation as a gratuitous disposal of property as set out in s55 excluded a transaction where some measure of consideration was given in exchange for the disposal of property.

SECTION 58 AND ITS ROLE WITHIN PART V OF THE ACT.

The word 'consideration' in section 58 is employed in the sense of a **quid pro quo** , that is some form of payment or compensation having some value. In my view, the purpose of this section is clearly to prevent a recipient from claiming that the giving of a **quid pro quo** for the property transferred to another , no matter the value thereof , prevents the disposal of such property from falling within the definition of donation in terms of section 55(1) ,namely any gratuitous disposal of the property, The Commissioner was therefore given a discretion to deem such a disposal to be donation, if in his opinion the consideration provided was not adequate . See ITC 1387; 46 SATC 121 at 124.

In **Ogus v SIR** 1978(3) SA 67(T) 79 F-H **Boshoff AJP** held that ' the word 'consideration' in s58 implied that there had to be a reciprocal obligation in terms of which the recipient would provide a **quid pro quo** which had been received.

In **Ogus, supra** the taxpayer donated a sum of R100,000 to trustees of a trust on certain

conditions. One of the clauses of the trust deed provided ‘It is an express condition of the donation by the donor that the trust should be liable for and shall indemnify him against all liability for donations tax in respect of the donation made in terms of this deed’. The taxpayer contended, **inter alia** the this clause imposed an obligation upon the trustees , the discharge of which constituted consideration for the disposition which had been made by the taxpayer. **Boshoff AJP** (at 79 G – H) rejected this argument thus: ‘[c]lause 20 is merely a term in the deed of trust dealing with the liability for the donations tax. It is in its context no more than a circumstance under which a trust was created by the appellant. It is certainly not in the nature of a reciprocal obligation. A reciprocal obligation is found in a synallagmatic contract, that is a contract which contains mutual reciprocal engagements by each of the two parties towards the other to perform his portion of the contract and this performance must take place **pari passu**…..There is nothing in the deed of trust that warrants the view that the appellant disposed of the R100,000 to the trustees for a consideration of the kind contemplated in s 58, and least of all, for a reciprocal obligation’.

Section 58 requires an examination of the transaction and the consideration received for the property to determine whether the consideration was so inadequate an amount as to enable the Commissioner to exercise his discretion and deem the disposition to be a donation.

Section 58 is not however relevant to this appeal. Appellant adopted the approach that the transaction was a donation in terms of s54 read together with the definition of donation in s55. In other words the appellant treated the disposal of property to the trust as a gratuitous disposition as defined. The disputed assessment was based on these sections. The letter of objection was based upon the contention that the transaction was not a donation as defined. The resolution of this dispute , being whether appellant assessed respondent correctly , turns on the applicability of section 54 read with the definition of donation in section 55 to the facts of this case; that is was the appellant justified in raising the assessment for donations tax. Donation is defined in s55 as being 'a gratuitous disposal of property'. By contrast the common law definition of donation connotes an act of pure liberality or generosity on the part of the donor. **Avis v Verseput** 1943 AD 331 at 353

As **Fagan P** held in ITC 1448; 51 SATC 58 at 63 in contrast to the common law the definition of donation in s55 includes disposals of property for which nothing was received in return, that is no consideration was received.

In the present case the trustees paid no consideration for the receipt of assets transferred to the trust. The trust deed empowered the trustees ' to pay or apply the whole of such portion of the net income of the Trust, as they in their sole discretion from time to time may determine, to or for the benefit….. of all or such one or more of the Beneficiaries….'. To the extent that such payment may have discharged the deceased from his obligation to pay maintenance to his ex-wife or minor child cannot itself constitute consideration paid by the trustees to the deceased in exchange for the receipt

of the assets transferred to the trust. It simply amounts to the Trustees carrying out their obligations in terms of the Trust Deed. It is not a consideration which emanates from the Trustees as a **quid pro quo** for the transfer of the assets.

In terms of section 82 of the Act the onus rests upon respondent to show ,on a balance of probabilities ,that the assessment for donations tax was incorrect. In order to, discharge this onus, respondent was required to provide evidence of the consideration given by the trust in exchange for the assets transferred by the deceased. Respondent restricted itself to the approach that, because the transferred assets took place as a result of an agreement between the spouses which was made an order of court, the transaction had not be motivated by liberality or generosity. Nowhere in the record is any such evidence provided.

There was some suggestion from respondent that evidence of the value of consideration was provided in the letter written by Mr Gillespie on 23 July 1998 in which he suggested that an amount of R754,000 be deducted as a liability for estate duty purposes. No substantiation of this figure is provided in the letter . Mr Gillespie was not called as a witness nor was the letter of 23 July 1998 presented as evidence before the Special Court.. To the extent that the trust accounts may be relevant, it does not appear that any amount of income was distributed to Mrs Welch for the years February 1997 and 1998. In the 1999 accounts an amount of R82,780 was awarded to Mrs Welch (in addition to an amount of R54,000 in favour of minor child, Tom Welch). There is nothing record which shows that these amounts represented a discharge of the maintenance obligation

owed by respondent to Mrs Welch.

Absent any evidence which would provide proof that consideration was given by the trust in exchange for the transfer of the assets, it cannot be said that respondent has discharged the onus of showing that the transfer of assets to the trust did not represent a donation as defined in terms of section 55 and that accordingly appellant was not justified in issuing the assessment which it did. For these reasons I would issue the following order.

1. The appeal succeeds with costs.

2. The assessment of the Commissioner 18/7/4/3/0783 is confirmed.

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DAVIS J

I agree and it is so ordered ________________

SELIKOWITZ J

I agree _______________

VAN REENEN J