IN THE HIGH COURT OF SOUTH AFRICA /ES

(TRANSVAAL PROVINCIAL DIVISION)

CASE NO: 24201/2007

DATE:

DELETE WHICHEVER IS NOT APPLICABLE

(1) REPORTABLE: YES/NO.

(2) OF INTEREST TO OTHER JUDGES: YES/NO.

(3) REVISED.

21/4/2008 .... DATE .... SIGNATURE

IN THE MATTER BETWEEN

VOLKSWAGEN OF SOUTH AFRICA (PTY) LTD — APPLICANT

AND

THE COMMISSIONER: SOUTH AFRICAN REVENUE SERVICE — RESPONDENT

JUDGMENT

SERITI, J

1. INTRODUCTION

This matter came to Court by way of motion.

In the notice of motion, the applicant is praying for an order in the following terms:

1. Declaring that the amounts of Secondary Tax on Companies ("STC") paid by the applicant to the respondent on the dates set out in annexure "X" attached to the papers and relating to dividends declared by the applicant

in favour of Volkswagen AG in 2004 and 2005, which amounts appear in the column marked "STC @ 12.5%" were in excess of the amount of STC properly chargeable under the Income Tax Act 58 of 1962, having regard to the provisions of the Agreement between the Republic of South Africa and the Federal Republic of Germany for the Avoidance of Double Taxation with respect to Taxes on Income concluded on 25 January 1973 and promulgated on 21 February 1975, ("the DTA").

2. Declaring that the amount of STC properly chargeable under the Act in relation to each such payment having regard to the provisions of the DTA, was that set out in the corresponding line in annexure "X" in the column marked "STC @ 7.5%".

3. Declaring, accordingly, that the applicant is entitled to a refund from the respondent in the sum of R51 458 041,00 (fifty one million four hundred and fifty eight thousand and forty one rands) in respect of overpayments of STC, such sum being made up of the amounts which appear in annexure "X" in the column marked "excess STC to be refunded:.

4. Directing the respondent to authorise and effect a refund to the applicant in the amount set out in paragraph 3 above.

5. In the alternative to paragraphs 1 to 4, declaring that the respondent is obliged to pay to the applicant the sum of R51 458 041,00 on the basis of the respondent having been unjustifiably enriched on the dates and in the amounts referred to in annexure "X" in the columns thereon marked "Date of STC payment" and "Excess STC to be refunded" respectively, by the payment on such dates by the applicant of STC which was not properly chargeable in terms of the Act, having regard to the provisions of the DTA.

6. 0rdering the respondent to make payment of the aforesaid sum of R51 458 041,00 to the applicant.

7. Directing the respondent to pay interest at the rate of 15.5% per annum from the date of each overpayment or from the date of service of this application.

2. FOUNDING AFFIDAVIT

It was attested to by Mr John Archibald Thomas Carse, Company Secretary/Treasurer of the applicant. He alleges that the applicant is resident in the Republic of South Africa for the purposes of the Income Tax Act 58 of 1962 and is duly registered for tax in South Africa.

The applicant is, and has at all material times been, a wholly owned subsidiary of Volkswagen Aktiengessellschaft ("VWAG"), a duly registered corporate entity resident in the Federal Republic of Germany. The applicant has, over the period from December 2001 to 0ctober 2005 declared a number of dividends in favour of its sole shareholder, VWAG. The dates on which the respective amounts of each such dividend are set out in the schedule marked annexure "X" attached to the founding affidavit.

In respect of each such dividend, the applicant filed a return for payment of STC and duly made payment to the respondent of 12.5% of the net dividend declared in the relevant dividend cycle. The applicant did not receive any dividend at any stage as the nett dividend declared in each cycle was the same as the dividend actually declared to VWAG.

The DTA is an agreement between South Africa and Germany which aims to avoid double taxation between the two countries. It was concluded on 25 January 1973, was duly approved by Parliament, and was promulgated pursuant to the provisions of section 108 of the Act on 28 February 1975.

At the time when the DTA was entered into, the provisions relating to STC did not exist. STC was introduced in 1993 by section 34(1) of the Income Tax Act 113 of 1993 which inserted sections 64B and 64C into the Act.

He further alleges that STC is a substantially similar tax to the tax on dividends that was in existence when the DTA became effective and as a result DTA applies to it as envisaged in Article 2 thereof. The applicant, from 31 July 2004 up to 30 November 2005 overpaid STC by an amount of R51 458 041,00 because it was charged 12.5% tax on dividends paid to its mother company instead of 7.5%.

As the applicant was charged and paid more than it should have been charged, applicant is entitled to claim a refund in terms of section 102 of the Act.

In a letter dated 29 November 2006 he, on behalf of the applicant submitted a claim for a refund of the STC overpayments. On 18 December 2006 there was a meeting between representatives of the applicant and the respondent. At the said meeting the applicant's representative raised the issue of the application of the DTA to STC. The respondent's representatives contended that the DTA did not apply to STC. The reason furnished for that contention was that STC is not a tax on dividends but a business tax and accordingly the DTA did not apply.

On 28 May 2007 the applicant sent a further letter to the respondent claiming the payment of refunds of STC overpaid.

He further alleges that despite the provisions of section 102 of the Act, the applicant is entitled to claim from the respondent any amounts of tax paid to it which are recoverable under the common law principles of unjustified enrichment.

3. ANSWERING AFFIDAVIT

It was attested to by Mr Nathan Morland, an employee of the respondent. He alleges that prior to dealing with the allegations made in the founding affidavit, he would summarise the respondent's defences to the claims in the notice of motion as follows:

(a) The respondent denies that STC represents a tax on dividends or the taxation of dividends as contemplated in Article 7 of the DTA and in particular denies that Article 7 applies to STC.

(b) The respondent alleges that Article 7 has not been incorporated into the domestic law of South Africa.

(c) The respondent denies that the applicant has paid any amount which exceeds the amount properly chargeable under the Income Tax Act.

(d) The respondent further alleges that if it is found that the applicant overpaid any amount (which is denied) respondent's view is that such amounts were paid in accordance with the practice generally prevailing at the date of the payments, and therefore the refund of such amounts is prohibited by the provisions of section 102(2)(a) of the Income Tax Act.

(e) The taxpayer's exclusive remedy in the event of an overpayment is that provided for in section 102 of the Income Tax Act and consequently the applicant is not entitled to base any claim for alleged overpayment on the grounds of enrichment.

He further alleges that Article 7 of DTA applies to the taxation of dividends and not to STC. STC does not represent the taxation of dividends or a tax charged on dividends as contemplated in Article 7. Furthermore Article 7 is not incorporated into the domestic law. The provisions of the DTA only became part of South Africa's domestic law to the extent that they constituted an arrangement contemplated in section 108(1).

At all relevant times, there has been no occasion where there has been a liability to pay STC by a South African resident company, and STC paid by such a company or accepted by the respondent at a rate other than the full rate provided for in section 64B(2) of the Income Tax Act. STC has been applied uniformly on all South African resident companies and no international tax treaty has ever been applied either by a South African resident company or by the respondent to reduce the rate at which STC is levied below the full rate provided for in section 64B(2).

In so far as South African resident companies have become liable for and have paid STC, the practice generally prevailing at all material times was for taxpayers to pay STC and for the respondent to accept payment at the full rate provided for in section

64B(2), which from 14 March 1996 has been 12.5%. That was the practice generally prevailing at the date when the applicant made the relevant payments of STC.

He further alleges that the DTA agreement was not ratified and promulgated as alleged by the applicant, although he admits that it was concluded on 25 January 1973.

He further alleges that article 2(3) lists the types of taxes on income in respect of which the DTA applied at that time. It did not include STC as STC was only introduced in 1993 by section 34 of the Income Tax Act 113 of 1993, which inserted sections 64B and 64C into the Income Tax Act with effect from 17 March 1993.

He denies that STC replaced the previous regime where tax on dividends was imposed and recovered at shareholder level. At the time STC was enacted, the only tax on shareholders was non-resident shareholders tax ("NRST"), which continued to apply until 1 0ctober 1995, when it was abolished, with the result that no withholding tax applied to dividends thereafter.

He denies that the applicant has a claim based on enrichment.

4. APPLICANT'S REPLYING AFFIDAVIT

It was attested to by Mr J A T Carse who attested to the founding affidavit. He alleges that STC is indeed a tax on dividends as contemplated in Article 7. It is in any event a substantially similar tax to, and has been imposed in addition to or in place of the

taxes which existed at the time the DTA came into effect. STC is a tax on dividends for purposes of Article 7, and as a result the STC charged by South Africa must be regarded as tax on the (dividend) income of the applicant's German parent (VWAG). Accordingly Article 7 does indeed relate to immunity, exemption or relief in respect of the same income.

He further alleges that in the present matter, whether or not Germany taxes dividends received by its domestic taxpayers from a South African company (something which Article 7(1) does not preclude it from doing) Article 7(2) permits the levying of a tax on dividends paid by a company resident in South Africa to a German shareholder, but precludes South Africa from imposing a tax of more than 7.5% on those particular dividends. Article 7 therefore acts to mitigate or limit the levying of tax in respect of the same (dividend) income, and consequently falls squarely within the ambit of section 108(1) and (2).

He further alleges that "practice generally prevailing" as envisaged in section 102(2)(a), refers to a practice which has not only been applied generally and habitually in the different offices of the respondent, but one which has developed openly based upon a common interpretation of the legal provision in question as between the respondent and the taxpaying community in general. Such a practice could not have developed where the applicability of a provision such as Article 7(2) was never expressly raised or considered.

The fact that STC has been paid at the rate provided for in section 64B of the Act and not on the basis provided for in Article 7(2) of the DTA, does not in the circumstances amount to a "practice generally prevailing".

Furthermore, the "practice generally prevailing" cannot be inconsistent with or contrary to the applicable law. To the extent that section 102(2)(a) infringes the legality principle, it is not enforceable and cannot override the express provisions of the DTA.

At the time of the conclusion of the DTA agreement, STC was not yet in existence and could not have been included by name, however Articles 2(3)(a) and 2(4) provide for a generic inclusion of all other taxes "on persons or on the incomes of persons" and of any identical or substantially similar taxes which are "substantially imposed in addition to, or in place of existing taxes".

He further alleges that the fact that STC does not become payable unless a dividend is declared means that it cannot be regarded as a tax on the income of the company declaring dividends. In the absence of a dividend declaration, no STC would become payable. It is the declaration of the dividend which gives rise to tax. The tax is therefore essentially a tax on dividend income distributed by the company. The liability for STC reduces the amount of the distributable income available for payment to the shareholder in a manner substantially similar to that which would apply to a withholding tax on dividends such as NRST.

5. FINDINGS

One of the fundamental issues that the Court must deal with in this case is whether Secondary Tax on Companies (hereinafter referred to as "STC") is affected by Article 7 of the "AGREEMENT BETWEEN THE REPUBLIC OF SOUTH AFRICA AND THE FEDERAL REPUBLIC OF GERMANY FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME" (which will hereinafter be referred to as "DTA"). The DTA was concluded in 1973 and promulgated in 1975.

The applicant's counsel in their heads of argument and during oral argument submitted that Article 7(2) of the DTA applies to limit the STC chargeable on dividends declared by it to Volkswagen AG.

On the other hand, the respondent's counsel, in their heads of argument and during oral argument, submitted that STC levied in terms of section 64B of the Income Tax Act 58 of 1962 does not represent a tax on dividends or the taxation of dividends as contemplated in Article 7 of the DTA.

Article 7 of the DTA reads as follows:

"(1) Dividends paid by a company which is a resident of a Contracting State, to a resident of the other Contracting State, may be taxed in that other State.

(2) However, such dividends may be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the law of that State, but the tax so charged shall not exceed:

(a) 7.5 per cent of the gross amount of the dividends if the recipient is a company (excluding partnerships) which owns directly at least 25 per cent of the voting shares of the company paying the dividends; ...

(4) The term 'dividends' as used in this Article means income from shares, 'jouissance' shares or 'jouissance' rights, mining shares, founders shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights assimilated to income from shares by the taxation law of the State of which the company making the distribution is a resident. It includes the income derived by a sleeping partner ... from his participation as such and income from distributions on certificates of an investment trust."

Part VII of the Income Tax Act *supra* deals with Special Tax on Companies. It was inserted by section 34(1) of Act 113 of 1993.

Section 64B(2) and (7) thereof reads as follows:

"(2) There shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the secondary tax on companies which is calculated at the rate of 12.5 per cent of the net amount, as determined in terms of subsection (3), of any dividend declared on or after 14 March 1996 by any company which is a resident. ...

(7) The secondary tax on companies shall be paid to the Commissioner by the company liable therefore by not later than the last day of the month following the month in which the dividend cycle relevant to such dividend ends and each payment of such tax shall be accompanied by a return in such form as the Commissioner may require ..."

Section 64C(2) reads as follows:

"(2) For the purposes of section 64B, an amount shall, subject to the provisions of subsection (4), be deemed to be a dividend declared by a company to a shareholder, where –

(a) any cash or asset is distributed or transferred by that company to or for the benefit of that shareholder or any connected person in relation to that shareholder; ...

(c) any debt owed by the shareholder or any connected person in relation to that shareholder to any third party is paid or settled by that company; ..."

The amounts deemed to be dividends in terms of section 64C(2) quoted above do not comply with the definition of dividend as contained in Article 7(4) of DTA.

As correctly submitted by the respondent's counsel, STC is a *sui generis* tax, which is calculated with reference to both actual dividends and amounts which are not

dividends but which in terms of section 64C(2) mentioned above are deemed to be dividends for the purposes of section 64B.

The applicant's counsel further submitted that STC as charged in South Africa, constitutes taxation on dividends and consequently Article 7(2) of the DTA is applicable to STC.

There is a difference between taxation on dividends and STC. STC is a tax on the company declaring the dividend. It is not paid by the recipient of the dividend. 0n the other hand, tax on dividends will be payable by the recipient of the dividend.

The respondent's counsel correctly submitted that STC is a tax on a South African resident company which is calculated with reference to the net amount of dividends declared by that company in a dividend cycle. It is triggered by a net outgoing payment of dividends in a dividend cycle.

The learned authors Lynette 0livier, Emil Brincker, Michael Honibal in their work titled *International Tax – A South African Perspective* at p376 said the following:

> "The question often arises as to whether STC can be said to be a tax on dividends and would thus qualify to be dealt with in terms of this article ... If it did, it would have resulted in the STC rate having to be reduced from 12.5% to say 5% ... However, it is important to bear that STC is not in fact a tax on dividends. Section 64B of the Act refers to the fact that STC is levied on the net amount of

any dividend declared by a company. Strictly speaking STC is a tax on the profits of a company which is payable by the company itself and not a tax on the dividends declared by a company, which would otherwise be payable by the shareholders. Unforeseen by the taxation authorities, STC thus has proved to be quite an effective tax on the basis that it is not to be reduced as opposed to any reduction that would have had to take place had the Government imposed a tax on dividends as such."

In *Integritax Newsletter: SAICA*, August 1994 – Contributor: Ernest & Young at p1, the following is stated:

"STC essentially applies to all dividends declared on or after 17 March 1993 as well as these declared before but paid after 17 March 1993. STC is a tax imposed on the company declaring the dividend and not on the shareholder and it does not affect any liability of the latter for the withholding of non-resident shareholder's tax. STC is levied at the rate of 25% ... on the distribution of the net amount remaining after deducting from any dividend declared the sum of all dividends which have accrued to the company during the previous 'dividend cycle' ending with that distribution."

The learned author R C William *Income Tax in South Africa, Law & Practice* 2nd edition at p440 states the following about STC:

"The tax is payable and borne by the company; it is not deductible from the amount of the dividend declared and is therefore not a tax which is payable by the

shareholder. STC is separate from and additional to a company's liability for normal tax. ... Because STC is determined separately from normal tax, a company which has an assessed loss may nonetheless be liable for STC if it declares dividends."

From the above discussion, it is clear that STC is not tax on dividends or taxation of dividends, but tax imposed on the company declaring the dividends.

My view is that STC is outside the ambit of Article 7 of the DTA.

The applicant's counsel, in the alternative submitted that the provisions of Article 7(2) apply to STC by virtue of Article 2(4) of the DTA.

Articles 2(3) and (4) of DTA reads as follows:

"(3) The existing taxes to which this Agreement shall apply are, in particular:

(a) in the Republic of South Africa:

the normal tax;

the undistributed profits tax;

the non-resident shareholder's tax;

the non-resident tax on interest;

the provincial income tax;

and all other taxes on persons or on the incomes of persons which are chargeable in South Africa; ...

(4) This Agreement shall also apply to any identical or substantially similar taxes which are subsequently imposed in addition to, or in place of the existing taxes."

In the case of STC, the entity liable for the dividend is the company declaring the dividend and the dividend declared is nett of tax – on the other hand, a withholding tax such as non-resident shareholder's tax was a tax on the shareholder's dividend income. As far as STC is concerned, same is levied on all South African resident companies when they declare dividends. On the other hand, withholding tax such as non-resident shareholder's tax is applicable only to certain type of shareholders, for example a non-resident shareholder. Furthermore, STC is a tax levied with reference to the net amount of a company's total dividends during a particular period, and on the other hand, non-resident shareholder's tax was levied on the amount of the dividend declared to the affected shareholder.

The above-mentioned differences between STC and a withholding tax negate the submission that STC is substantially similar to a withholding tax such as non-resident shareholder's tax.

STC is a taxation of the company declaring a dividend and is not a taxation of the recipient of the dividend, and consequently as stated earlier Article 7 of the DTA does not apply to STC.

The above conclusion is further supported by a proper reading and analysis of Article 7(2)(a) which refers to a recipient of dividends and not to a company declaring the dividend. The benefits conferred by the said Article are to be enjoyed by the recipients of the dividends and not the company declaring the dividends.

As a result of the conclusion that I have arrived at on the nature and characteristics of STC, I do not believe that it is necessary for me to deal with the other issues raised in this case, namely whether the provisions of section 102 of the Income Tax Act precludes a tax payer who has overpaid tax from claiming a refund or not, or whether the common law remedy of *condictio indebiti* is available or not to such tax payer.

The court therefore makes the following order:

1. The application is dismissed.
2. The applicant is ordered to pay the respondent's costs on a party and party scale, which costs will include costs consequent upon the employment of two counsel.

W L SERITI
JUDGE OF THE HIGH COURT

24201-2007

HEARD ON: 14 APRIL 2008
FOR THE APPLICANT: M SELIGSOM SC & M JANISCH
INSTRUCTED BY: SOLOMON NICOLSON
FOR THE RESPONDENT: P SOLOMON SC & J CANE
INSTRUCTED BY: CHEADLE THOMPSON & HAYSOM INC