**THE SUPREME COURT OF APPEAL OF SOUTH AFRICA**

**JUDGMENT**

**Reportable**

Case no: 142/2017

In the matter between:

**COMMISSIONER FOR THE SOUTH AFRICAN**

**REVENUE SERVICE** **APPELLANT**

and

**THE EXECUTORS OF ESTATE LATE SIDNEY**

**ELLERINE** **RESPONDENT**

**Neutral citation:** *CSARS v The Executors of Estate Late Sidney Ellerine* (142/2017) [2018] ZASCA 39 (28 March 2018)

**Coram:** Navsa, Wallis and Mbha JJA, Davis and Hughes AJJA

**Heard**: 6 March 2018

**Delivered**: 28 March 2018

**Summary:** Eighth Schedule to the Income Tax Act 58 of 1962 – valuation of preference shares for the purposes of determination of a capital gain.

## ORDER

**On appeal from:** Gauteng Tax Court, Johannesburg (Victor J sitting as a court of first instance):

1. The appeal is upheld with costs, including the costs of two counsel.
2. The order of the Tax Court of 11 October 2016 is set aside and replaced with the following order:

   'The deceased was entitled, on the date of his death, to convert the preference shares to ordinary shares and the preference shares must be valued, for the purposes of paragraph 40 read with paragraph 31(3) of the Eighth Schedule to the Income Tax Act, on this basis.'

## JUDGMENT

**Davis AJA (Navsa, Wallis and Mbha JJA and Hughes AJA concurring)**

### Introduction

[1] This case concerns the valuation of preference shares for the purposes of determining a capital gain in terms of paragraph 40 read together with paragraph 31(3*)(a*)(i) of the Eighth Schedule to the Income Tax Act 58 of 1962 (the Act).

[2] The issued preference shares were held by the late Sidney Ellerine ('deceased'). They formed part of the share capital of Sidney Ellerine Trust (Pty) Ltd

('the company') which, in total, consisted of 600 ordinary shares of R1 each and 112 000 7 per cent redeemable non-cumulative preference shares of R1 each.

[3] The deceased held all of the redeemable preference shares issued by the company. The registered and beneficial owners of the ordinary shares were as follows:
200 owned by the trustees of The Kevin Murray Ellerine Trust;
200 owned by the trustees of The Bradley Charles Ellerine Trust;
100 owned by the trustees of The Linda Caron Ellerine Trust;
100 owned by the trustees of The Maxine Tamar Ellerine Trust.

[4] The preference and ordinary shares enjoyed one vote for each share in general meetings of shareholders so that the deceased held the overwhelming majority of the voting rights in the company. Appellant assessed respondent's liability for capital gain, determining that the deceased was entitled, by using his voting power, to convert these preference shares to ordinary shares. Appellant assessed the value of the preference shares in the amount of R 563 376 418, on the basis that the shares represented 99.47 per cent of the share capital of the company and thus should be valued at 99.47 per cent of the value of the company.

[5] Respondent submitted that the terms of special condition 5.8 of the Memorandum read together with Articles 4.2 and 34 of the Articles of Association of the company precluded the deceased from converting these preference shares to ordinary shares, without the voting support of at least 75 per cent of the ordinary shareholders; hence the preference shares should be valued at their fair value of R1 per share.

[6] The only issue before the Tax Court was whether the rights that attached to the preference shares and which entitled the holder thereof to convert them should be taken into account in the determination of the market value.

[7] After interpreting the relevant provisions of the Memorandum and Articles of Association, the Tax Court concluded that, on the date of his death, the deceased was not entitled to convert the preference shares to ordinary shares, in that, at least 75 per cent of the holders of each class of shares had to agree to the conversion. The court held that, contrary to special condition 5.8 of the Memorandum, the conversion would result in an amendment to the terms applicable to these preference shares as provided for in Article 34 of the Articles of Association and consequently their rights. However, without the prior written approval of at least 75 per cent of the holders of each class of shares, Article 34 could not be amended. It was common cause that no such approval had been obtained.

[8] On this basis the Tax Court held that the deceased at the time of his death was not entitled to convert the preference shares to ordinary shares. The preference shares had to be valued accordingly for the purposes of paragraph 40 read together with paragraph 31 (3) of the Eighth Schedule to the Act.

**The nature of the appeal**

[9] The dispute in this case thus turned on the resolution to two questions:

1. Could the holder of the deceased's preference shares convert these shares into ordinary shares without an amendment to Article 34 of the Articles of Association, which, when read with special condition 5.8, required the written approval of 75 per cent of the holders of each class of shares in the issued share capital of the company.
2. Whether, in terms of Article 4.2, conversion of the deceased preference shares to ordinary shares could take place without the approval of 75 per cent of the holders of the ordinary shares.

[10] An analysis of these arguments requires an examination of the relevant provisions of the company's articles as well as special condition 5.8.

**The background**

[11] The material parts of this case are set out in a statement of agreed facts. Since 1969 the deceased had been the registered owner of the issued preference share capital of 112 000 7 per cent redeemable non-cumulative preference shares of R1 each. These shares conferred upon the holder, being the deceased, the right to vote 99.47 per cent of the votes at general meetings of the company.

[12] The company, in which the deceased enjoyed the controlling interest, held 40 per cent of the issued share capital in another company, Ellerines Brothers (Pty) Ltd (EB), an investment holding company, which owned the bulk of the family investments. The remaining 60 per cent of EB shares were held by Eric Ellerine Trust (Pty) Ltd (EET) a company controlled by the deceased's brother Eric Ellerine. The dispute concerning the value of the preference shares necessitates an examination of key provisions of the company governance structure.

[13] On 12 May 2006 two special resolutions were unanimously adopted by the company in terms of which an amendment was made to the company's Memorandum and Articles of Association, which amendments were then registered under the Companies Act 61 of 1973.

[14] In terms of Special Resolution 1, it was resolved to amend the company's Memorandum of Association by the inclusion of special conditions in terms of s 53(a) of the Companies Act in a new paragraph 5 of the Memorandum of Association. This dealt with restrictions on the disposal of shares of the company prior to a certain event, described as 'a distribution event', being 10 November 2033, the hundredth anniversary of Eric Ellerine's birth.

[15] A new paragraph 5.2 was inserted to define the term 'dispose' as including to sell, alienate, transfer, exchange, pledge, encumber or otherwise dispose of (including but not limited *eiusdem generis* by way of repurchase, donation, dividend

or by way of the terms of a will). 'Disposal' bore a corresponding meaning, unless a contrary intention appeared.

[16] A further part of special resolution 1 was the inclusion of clause 5.8 which provided:

'This special condition and also the provisions of articles 29 and 34 of the company's Articles of Association may be amended only by way of the passing and registration of a special resolution which shall be of no force or effect unless the prior written approval of at least 75% (seventy five percent) of the holders of each class of shares in the issued share capital of each of the company and Eric Ellerine Trust (Proprietary) Limited is obtained for so long as Eric Ellerine Trust (Proprietary) Limited holds any shares in Ellerine Bros (Proprietary), or any successor in title thereto.'

[17] Special Resolution 2 provided that the existing Articles of Association dated 13 December 1968 be abrogated in their entirety and be replaced with a fresh set of Articles of Association dated 12 May 2006. These were in force at the time of the deceased's death.

[18] Turning to the rights of a preference shareholder, Article 34, headed 'Redeemable Non-Cumulative Preference Shares', provided in Article 34.1 that a number of rights, privileges and conditions attached to these preference shares, including that they conferred the right to a preferential dividend at the rate of 7 per cent per annum on the capital, paid out of the profits of the company resolved to be distributed in respect of each financial year, but not to an entitlement to any further profits.

[19] As is typical in these provisions, article 34.2 limited the right of preference shareholders to have a preferential right to repayment of capital paid but with no further rights to participate in or receive assets or capital.

[20] Article 34.3 provided that holders of the preference shares would have the right to attend and vote at all meetings of the company. At each such meeting,

whether on a show of hands or on a poll, every holder of a preference share, in person or represented by proxy at any such meeting, 'shall have one vote for each preference share of which he is a holder'.

[21] Article 34.4 provided that the company shall 'by resolution of the directors to that effect, be entitled to redeem the whole or any part of the preference shares for the time being issued and outstanding out of any monies which may lawfully be applied for such purpose at par, upon giving the holder of the Shares to be redeemed not less than 1 (one) month's prior written notice, provided that no such notice may be given so as to expire prior to the occurrence of the Distribution Event….'

[22] The determination of whether a conversion of preference shares to ordinary could take place without the consent of ordinary shareholders is further affected by Article 4.2, which provides:

'All or any of the rights, privileges or conditions for the time being attached to any class of Shares for the time being part of the share capital of the company may (unless otherwise provided by the terms of issue of the Shares of that class) whether or not the company is being wound up, be varied in any manner with the consent in Writing of the holders of not less than 3/4 (three-fourths) of the issued Shares of that class, or with the sanction of a resolution passed in the same manner as a special resolution of the company at a separate general meeting of the holders of the Shares of that class….'

[23] Article 7.1.10, which specifically dealt with the conversion of shares, provides:

'7.1 The company may from time to time by special resolution -

7.1.10 convert any shares in the capital of the company to Shares of a different class and in particular (but without derogating from the generality of the foregoing) convert ordinary Shares or Preference Shares to redeemable preference Shares.'

**The key issue for determination**

[24] Appellant was required in terms of the Eighth Schedule to the Act to make a determination of the capital gains resulting from the deemed disposal of the

deceased's preference shares. Paragraph 40 (1) of the Eighth Schedule provides that 'a deceased person is treated as having disposed of his/her assets … for an amount received or accrued equal to the market value of those share at the date of the person's death'.

[25] The market value of the shares in a company, not listed on a recognised exchange, must be determined as the value equal to the price that could have been obtained upon the sale of the shares between willing buyer and a willing seller dealing at arm's length in an open market.[1]

[26] As noted, appellant valued the preference shares at the date of the deceased death in the amount of R563 376 418. By contrast, respondent contended that the value of the preference shares as at the date of the deceased's death was equal to the par value of the shares, namely R112 000.

[27] The essence of appellant's case is set out in its Rule 10 Statement as follows: 'The nominal value of the 112,000 preference shares does not reflect the market value of the shares, as the voting rights attached to the shares entitled the deceased to convert his preference shares into ordinary shares at any stage after 9 May 2006, this by virtue of article 7.1.10 of the Articles adopted on 09 May 2006 by the Company, and notwithstanding the provisions of Special Condition 5.8.'

[28] Respondent contended that the value of the preference shares must be determined on the basis that the holder was precluded from converting these shares to ordinary shares without obtaining the prior written approval of at least 75 per cent of the ordinary shareholders and at least 75 per cent of the holders of each class of shares in EET. This argument is based firstly upon special condition 5.8 read with Article 34 and, secondly, on a reading of Article 4.2. Respondent accepted that, apart from these arguments, the deceased would have been able to convert his preference shares into ordinary shares in terms of Article 7.1.10.

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[1] Paras 31 (3) of the Eighth Schedule to the Act.

**The argument based upon special condition 5.8**

[29] Respondent was constrained to accept that , on a plain reading of the words 'articles 29 and 34… may be amended…' ,there was no need to amend article 34 in order for preference shares issued by the company to be converted to ordinary shares. On this reading, special condition 5.8 would not be engaged by such a conversion and the restrictions it embodies would not apply to it.

[30] Its argument was based on an interpretation of the purpose of special condition 5.8 as protecting the shareholders of 'each class of shares' (which included both the ordinary shares and the preference shares), from amendments to the terms of the preference shares which might impact upon their rights as shareholders. On the basis of this purpose of the special condition, the word 'amended' had to be interpreted to mean that, if the rights attached to the preference shares of the deceased as provided for in Article 34 were amended, special condition 5.8 applied. A conversion of the preference shares to ordinary shares would, on this argument alter the 'rights', privilege and conditions of the deceased's preference shares as provided for in Article 34 and hence Article 34 would have been amended.

[31] Whatever debate may be developed with regard to the context urged upon this court by respondent's counsel, 'consideration must be given to the language used in the light of the ordinary rules of grammar and syntax'.[2] While the intention of the speaker is a vital component of the interpretive inquiry, the basic unit of meaning remains the sentence employed.

[32] In the present case the sentence in Article 34 which commences 'the Preference Shares shall be subject to the following rights privileges and conditions', refers to the preference shares and not to a particular holder of these preference shares. To the extent that there may be any doubt about this construction, Article 34.6 makes it clear that the entire article concerns the rights attached to the

[2] *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at para 18

preference shares as opposed to the rights of a particular holder thereof, in particular where it provides: 'no further shares ranking in priority to or *pari passu* with the preference shares shall at any time be created without the consent or sanction of the holders of such last preference shares which may be issued and outstanding given in accordance with Article 4.2 unless such further shares be created and issued for the purpose of redeeming out of the proceeds of the issue thereof the preference shares mentioned in this Article 34 or such of the said shares as shall for the time being be issued and outstanding'.

[33] Any interpretation regarding a company's articles must be located within the context of the nature of articles of association which confer rights or impose obligations on person who are members. There is, in short, a recognized distinction between contracts made by a company with members in their private capacity and those made in their capacity as members[3]. Respondent appears to contend that without any clear language nor authority to support its argument, a contract was concluded between the company and the deceased in his personal capacity. There is no foundation for this submission.

**The Article 4.2 argument**

[34] Respondent contended that, if the deceased's preference shares were converted to ordinary shares, the rights attaching to the existing ordinary shares would be varied as a consequence thereof. The variation for which it contended was a drastic drop in the value of those shares. For this reason, article 4.2 would be of application and hence the conversion would require the approval of 75 per cent of the holders of the ordinary shares.

[35] English law appears to support the view that a variation of rights occurs when the rights which attach to the shares are varied and not when they become commercially less valuable. Where additional preference shares and ordinary shares

[3] *Rosslare (Pty) Ltd v Registrar of Companies* 1972 (2) SA 524 (D & CLD) at 528 A-B, LAWSA (first re-issue) Vol 4 Part 1 at para 73 in respect of the 1973 Companies Act. The position remain the same under the Companies Act 71 of 2008. LAWSA (second edition) Vol 4 Part at para110

had been issued, it was held that the rights of preference shareholders had not been varied. *White v Bristol Aeroplane Co Ltd* [1953] Ch 65 at 74 – 80. When the voting power of certain ordinary shareholders had been diminished as a result of subdivision of other ordinary shares it was held that there had been no variation of rights. *Greenhalgh v Arderne Cinemas Ltd* [1946] 1 All ER 512 (CA)[4].

[36] In the present case, the deceased through the preference shares enjoyed sufficient voting power to ensure a conversion of the preference shares to ordinary shares. While the voting rights of the respective class of shareholders would not have changed, by means of the conversion, the value of the existing issued ordinary shares would have declined in value by way of the increased number of the ordinary shares pursuant to the conversion. However, to fall under the scope of rights being "varied" it would then have been necessary to interpret the phrase to mean that the shares of the ordinary shareholders were now commercially less valuable. The balance of the voting power would not be changed nor would there be any alteration of the rights, privileges and conditions attaching to the ordinary shares as a class[5].

[37] A further problem which confronts respondent's argument is the express wording of Article 7.1.10 which, as is clear from the text thereof, provides that any class of shares, by special resolution, can be converted to shares of a different class, absent any other provision in the articles to the contrary. It is clear that the deceased, by virtue of holding the overwhelming majority vote could have converted the preference shares to ordinary shares. This article is not qualified by a reference to article 4.2, both of which were part of the original articles of the company. Had it been intended to impose a qualification upon the position as set out in article 7.1.10, express language would have been required to make this position clear. The

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[4] For the distinction between variation of rights and shares that become commercially less valuable, see *White*, supra at 74; and the minority judgment of Trollip JA in *Utopia Vakansie-Oorde Bpk v Du Plessis* 1974 (3) SA 148 (A) at 181-182. Blackman, Jooste and Everingham *Commentary on the Companies Act* Volume 1 at 5-286 argue that this distinction drawn in English law is equally applicable in South African company law.

[5] Blackman, Jooste and Everingham *Commentary on the Companies Act* Volume 1 5-288. see also Gower and Davies *Principles of Modern Company Law* (8th ed) at 668.

express meaning given to article 7.1.10 finds further support in that the overall consequence of these two articles is a congruence with the distinction between an effect on rights, as opposed to a consequence of a diminished commercial value. Article 4.2 deals with the former, while a conversion to ordinary shares in terms of article 7.1.10 caters for a situation where only the latter result might follow. The result is that the argument based on Article 4.2 fails.

**Costs**

[38] Both parties were agreed that the Tax Court wrongly made a cost order against appellant. In terms of s 130(1)*(a)* of the Tax Administration Act 28 of 2011 a tax court may grant a costs order in favour of a taxpayer if SARS' grounds for assessment or 'decision' are held to be unreasonable; suffice to say that no such reason was given by the Tax Court as to its award of costs.

[39] In the result:

1. The appeal is upheld with costs, including the costs of two counsel.
2. The order of the Tax Court of 11 October 2016 is set aside and replaced with the following order:

   'The deceased was entitled, on the date of his death, to convert the preference shares to ordinary shares and the preference shares must be valued, for the purposes of paragraph 40 read with paragraph 31(3) of the Eighth Schedule to the Income Tax Act, on this basis.'

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D Davis
Acting Judge of Appeal

APPEARANCES

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|---|---|
| For the Appellant: | A R Sholto-Douglas SC with N Bawa SC |
| Instructed by: | State Attorney, Bloemfontein |
| | |
| For the respondent: | P A Solomon SC with J Boltar |
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