THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case no: 1026/17

In the matter between:

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

and

RYNETTE PIETERS **FIRST RESPONDENT**

GEORGE DA SILVA RAMALHO **SECOND RESPONDENT**

EZECHIEL ALBERT BEDDY **THIRD RESPONDENT**

Neutral citation: *Commissioner, South African Revenue Service v Pieters and others* (1026/17) [2018] ZASCA 128 (27 September 2018)

Coram: Navsa, Tshiqi, Majiedt, Willis and Swain JJA

Heard: 10 September 2018

Delivered: 27 September 2018

Summary: Income Tax – employees' tax (PAYE) – contracts of employees terminated in terms of s 38(9)(*b*) of Insolvency Act 24 of 1936 – awards to employees not subject to PAYE in terms of paragraph 2(1)(*a*) of Fourth Schedule to the Income Tax Act 58 of 1962.

ORDER

On appeal from: Western Cape Division of the High Court, Cape Town (Pillay AJ sitting as court of first instance):

The appeal is dismissed with costs, including the costs of two counsel.

JUDGMENT

Majiedt JA (Navsa, Tshiqi, Willis and Swain JJA concurring):

[1] Prior to its demise, Slabbert Burger Transport (Pty) Ltd (the company) was a large transport business with its main place of business in Wellington in the Western Cape. The company was finally wound up in the Cape Town high court on 8 February 2013. The company's shareholders initially resolved that it be wound up by way of a creditors' voluntary winding-up. The resolution was registered at the Companies and Intellectual Property Commission on 7 December 2012. Ultimately, however, the company was wound up by the court on the basis that it was unable to pay its debts.[1]

[2] The company had some 700 employees. Their employment contracts were in terms of s 38(1) of the Insolvency Act 24 of 1936 (the Act), suspended on the date of the commencement of the winding-up on 7 December 2012. The contracts came to an automatic end 45 days later by virtue of the provisions contained in s 38(9) of the Act.[2] At the time of the commencement of the company's winding-up, leave pay had accrued to the employees.

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[1] Since the company was unable to pay its debts, its winding-up was subject to insolvency law as contemplated by s 339 of the previous Companies Act, 61 of 1973.

[2] Section 38(9) reads:

'(9) Unless the trustee or liquidator and an employee have agreed on continued employment

[3] The three respondents, Ms Rynette Pieters and Messrs George Da Silva Ramalho and Ezechiel Albert Beddy, were appointed provisional liquidators of the company on 12 December 2012, with their appointment made final on 19 March 2013. They prepared a liquidation and distribution account (the L&D account). Prior to the confirmation of the L&D account, the respondents awarded and paid to the company's employees certain amounts, which included salaries, leave and severance pay. The respondents did not deduct any employees' tax in accordance with para 2 of the Fourth Schedule to the Income Tax Act 58 of 1962. The payments totalled R9 580 319.12.

[4] On 21 August 2014 the Commissioner objected to the confirmation of the L&D account. His objection was based on the respondents' failure to deduct employees' tax (commonly known as 'pay as you earn' or 'PAYE') from the amounts. It was the Commissioner's case initially, that the respondents became the 'representative employer' as envisaged in the definition section of para 1(a) of Part 1 of the Fourth Schedule to the Income Tax Act. The Master upheld the Commissioner's objection against the contrary view postulated by the respondents, namely that the payments are preferent awards under the Act, not subject to PAYE. The Master's decision was that the respondents were statutorily obliged to effect PAYE deductions from the payments made to the employees. He took the view that the liquidators were representative employers as contemplated in the Schedule and that PAYE is payable by them in respect of the remuneration of the employees. The respondents successfully approached the Western Cape Division of the High Court, Cape Town, (the high court) for the review and setting aside of the Master's decision and directions. This appeal is with the leave of that court.

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of the employee in view of measures contemplated in subsection (6), all suspended contracts of service shall terminate 45 days after –
(*a*) the date of the appointment of a trustee in terms of section 56; or
(*b*) the date of the appointment of a liquidator in terms of section 375 of the Companies Act, 1973; or
(*c*) the date of the appointment of a co-liquidator in terms of section 74 of the Close Corporations Act, 1984, or if a co-liquidator is not appointed, the date of the conclusion of the first meeting.'

[5] The Master's directions were as follows:

'(a) The joint liquidators are directed to amend the First Liquidation and Distribution Account to include the payment of PAYE as an admin expense on all remuneration earned by employees of Slabbert Burger Transport (Pty) Ltd (in Liquidation) on the amount of R9 580 319.12 made in terms of s 98A of the Insolvency Act.

(b) If the said employees have already been paid, the joint liquidators are directed to deduct all the PAYE that would have been paid to SARS out of their fees and lodge an Amended First Liquidation and Distribution Account within 14 days of this ruling'.

[6] The central question is whether payments made in terms of s 98A of the Act are subject to the deduction of PAYE contemplated in para 2(1) of the Schedule. It was common cause that the payments related to salaries, accumulated leave and severance pay. In relevant part, s 98A reads as follows:

'98A **Salaries or wages of former employees of insolvent**

(1) Thereafter any balance of the free residue shall be applied in paying –

(*a*) to any employee who was employed by the insolvent –

(i) any salary or wages, for a period not exceeding three months, due to an employee;

(ii) any payment in respect of any period of leave or holiday due to the employee which has accrued as a result of his or her employment by the insolvent in the year of insolvency or the previous year, whether or not payment thereof is due at the date of sequestration;

(iii) any payment due in respect of any other form of paid absence for a period not exceeding three months prior to the date of the sequestration of the estate; and

(iv) any severance or retrenchment pay due to the employee in terms of any law, agreement, contract, wage-regulating measure, or as a result of termination in terms of section 38; . . . .

(2) (*a*) In order to ensure that the balance of the free residue is applied in an equitable manner, the Minister may by notice in the *Gazette* determine maximum amounts which shall be paid out in terms of subsection (1) in respect of –

(i) paragraph (*a*), any or all the subparagraphs thereof or any single employee; . . . .'

[7] As is evident:

(a) the payment of salaries or wages to former employees for a maximum period of three months are included in s 98A(1)(*a*)(i);

(b) leave or holiday pay which has accrued are included in s 98A(1)(*a*)(ii); and

(c) severance or retrenchment pay is included in s 98A(1)(*a*)(iv).

Paragraph 2(1) of the Schedule places an obligation on an employer or a representative employer who is not a resident, to deduct or withhold from an employee's remuneration an amount of employees' tax. For the reasons that follow, I am of the view that no such obligation arises in respect of the payments made to the employees in this case.

[8] Section 98A was inserted into the Insolvency Act by s 2 of the Judicial Matters Amendment Act 122 of 1998. The section affords a preference to the payment of the amounts in question to employees. The amounts are subject to limitations (a maximum of three months in respect of unpaid salaries and wages and subject to an overall cap in each of the categories determined by the Minister of Justice.)[3] The amounts presently thus determined by the Minister are relatively small. They are:

(a) R12 000 in respect of unpaid salaries and wages;

(b) R12 000 for severance pay; and

(c) R4 000 in respect of leave pay.

The claims of employees envisaged in s 98A(1)(*a*) need not be proved (s 98A (3)).

[9] An initial attempt by the Commissioner to distinguish severance pay from the other two categories was eventually abandoned and counsel on his behalf accepted that such amounts are no different than unpaid salaries and

[3] See s 98A (2) and Notice No G 865, GG 21519 of 1 September 2000.

wages and leave pay. That concession is sound – severance pay is clearly included in s 98A(1)(*a*)(iv). Furthermore, severance pay is calculated in terms of s 41 of the Basic Conditions of Employment Act 75 of 1997 – one week of pay for every year employed. That calculation clearly pertains to the pre-liquidation period, given the fact that an employee is generally precluded from performing work after the commencement of liquidation (s 38(2)(*a*)).

[10] The preference afforded these payments must be understood against the backdrop of the importance of a *concursus creditorum*, which is generally recognized as a foundational concept in our law of insolvency. It was described as follows in *Walker v Syfret*:[4]

'The object of the [Insolvency Act] is to ensure a due distribution of assets among creditors in the order of their preference.'

Nothing may be done which would result in the diminishing of the assets in an insolvent estate or which would prejudice the rights of creditors.[5] A liquidator is enjoined to safeguard the integrity of the *concursus creditorum*. A liquidator's overriding duty is to the estate and to the general body of creditors.[6] The free residue in the estate must be distributed by the liquidator to the creditors strictly in the order of preference laid down in sections 96 to 102 of the Act.[7] Thus, for example, an insolvent cannot reach an arrangement with its trustee or liquidator to pay in full the claim of a particular creditor in the estate. In those circumstances this court has held that such an agreement would enable the parties to subvert the scheme of distribution set out in the Act.[8] Sections 96 – 102 constitute a numerus clausus of the ranking of statutory preferences in respect of the distribution of the free residue.[9]

[11] Reverting to s 98A – the provisions contained therein can rightly be described as having a social justice objective as they are clearly aimed at

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[4] *Walker v Syfret* 1911 AD 141 at 166.
[5] *Ward v Barrett NO & another* 1963(2) SA 546 (A) at 552D – H.
[6] *Commissioner of the South African Revenue Service v Stand Two Nine Nought Wynberg (Pty) Ltd & others* [2005] ZASCA 55; 2005 (5) SA 583 (SCA) para 14.
[7] Section 391, read with s 342 of the Companies Act 61 of 1973.
[8] *Commissioner of the South African Revenue Service v Stand Two Nine Nought Wynberg (Pty) Ltd,* supra, footnote 7 *para 8*.
[9] *Cooper NO & andere v Die Meester & 'n ander* 1992 (3) SA 60 (A) at 82G-I.

alleviating the plight of employees who are left unpaid by the financial woes of their liquidated employer company. More often than not, as the present instance demonstrates, these would be vulnerable blue collar employees. The Legislature plainly deemed it necessary to attenuate the impact which liquidation may have on a company's employees. But it chose to do so carefully, by imposing a three month limit in respect of unpaid salaries and wages and in placing a cap on the various amounts. It is significant that the capped amounts, set out in para 8 above, are relatively modest. The objective is to ensure that the remainder of the free residue is applied equitably.[10] The limited relief proffered by s 98A has the effect that employees have to stand at the end of the order of preference queue for the balance of their salaries (ie above the three month limit and the cap). Self-evidently, employee tax deductions would reduce the modest amounts under s 98A.

[12] Against this backdrop it is difficult to conceive how PAYE deductions would apply to these modest amounts, legislated to relieve the burden on vulnerable, mostly blue collar workers, left stranded by a financially distressed employer company. A close analysis of para 2(1) of the Schedule leads to the compelling conclusion that its provisions do not apply to s 98A payments. First, the insertion of s 98A in the Act during 1998 caused a striking re-arrangement in the order of preference. Prior to its insertion, preference under certain statutory obligations (including PAYE under the Schedule) ranked above the salaries and wages of employees. That order was reversed by the insertion. The salaries and wages of employees now rank just below the costs of execution and above preference under certain statutory obligations, which includes PAYE under the Schedule. The change was plainly deliberate.

[13] Section 99(1)(*a*)(iv) of the Act deals with employees' tax. It provides that SARS holds a preference to 'any amount which the insolvent . . . has under the provisions of the Fourth Schedule to [the Income Tax Act] deducted or withheld by way of employees' tax from remuneration or any other amount paid or payable by him to any other person. . . '. It was common cause that

[10] Section 98A(2)(*a*) of the Act.

there is no indication that prior to its liquidation the company deducted or withheld any amounts in respect of employees' tax contemplated in this section. The subsection therefore finds no application here. Ordinarily, PAYE would be calculated with periodic deductions utilising the relevant tax tables, based on the contemplated annual income. Liquidation would usually occur in an intervening period of a particular tax year. A correct calculation of the tax actually due or which SARS may have to refund to the taxpayer, would in such circumstances only be able to be properly calculated after the end of the tax year. This is a further reason why the Commissioner's contentions cannot be upheld.

[14] Section 101(*a*) provides for the preference (after settlement of the s 99 preferences) of 'any tax on persons or the income or profits of persons for which the insolvent was liable under any Act of Parliament or ordinance of a Provincial Council in respect of any period prior to the date of sequestration of his estate, whether or not that tax has become payable after that date'. As stated, para 2 of the Schedule obliges an employer to deduct and pay over to SARS employees' tax on remuneration payable to employees. Paragraph 4 of the Schedule provides that any amount 'required to be deducted or withheld in terms of paragraph 2 shall be a debt due to the state and the employer concerned, shall save as otherwise provided, be absolutely liable for the due payment thereof to the Commissioner'.

[15] During argument counsel for the Commissioner abandoned the initial contention that the respondents, qua liquidators, were liable for the payment of PAYE as 'representative employer within the definition contained in Part I of the Schedule. Instead, counsel placed reliance on the definition of 'employer' for such liability. 'Employer' is defined as follows in the definitions provision:

'any person (excluding any person not acting as a principal, but including any person acting in a fiduciary capacity or in his capacity as a trustee in an insolvent estate, an executor or an administrator of a benefit fund, pension fund, provident fund, retirement annuity fund or any other fund who pays or is liable to pay to any person any amount by way of remuneration, and any person responsible for the payment of

any amount by way of remuneration to any person under the provisions of any law or out of public funds (including the funds of any provincial council or any administration or undertaking of the State) or out of funds voted by Parliament or a provincial council'.

'Representative employer' is defined as follows:

'(*a*) in the case of any company, the public officer of that company, or, in the event of such company being placed under business rescue in terms of Chapter 6 of the Companies At, in liquidation or under judicial management, the business rescue practitioner, liquidator or judicial manager, as the case may be;

(*b*) . . .

(*c*) . . .

(*d*) . . .

who resides in the Republic, but nothing in this definition shall be construed as relieving any person from any liability, responsibility or duty imposed upon him or her by this Schedule'.

[16] It is striking that a clear distinction is made in these definitions between the trustee in an insolvent estate, who is expressly included in the definition of an 'employer' and the liquidator of a company who is expressly included in the definition of a 'representative employer'. The argument on behalf of the Commissioner therefore fails at first base. This unequivocal distinction by the Legislature supports the earlier judgment in *Van Zyl NO v Commissioner for Inland Revenue*[11] (the present definition of 'employer' in the Schedule was effected in 2008 and that of 'representative employer' in 2014.)

[17 It was forcefully contended that the interpretation advanced on behalf of the Commissioner that s 98A payments are subject to PAYE under the Schedule, would not violate the statutory order of preference in the Act. This contention is unsound for the reasons set out earlier. It is worth repeating that there is nothing in the relevant provisions of the Schedule which bears out an intention to include a preference in the closed list of preferences in sections 96 – 102 not expressly mentioned there. Upholding this contention would also lead to startling anomalies. One example would suffice – if prior to liquidation

[11] *Van Zyl NO v Commissioner for Inland Revenue* 1997 (1) SA 883 (C).

the company had in fact withheld PAYE deductions, but failed to pay it over to SARS, the amounts would fall under s 99(1)(*b*)(ii). If the s 98A payments were to be subject to PAYE, as the Commissioner contends, they would rank ahead of s 99(1)(*b*)(ii) PAYE amounts. This distinction in the ranking of PAYE payments is devoid of any reason and is untenable in law. The startling discrepancy does not arise if, as we hold, s 98A payments are not subject to PAYE in terms of para 2(1) of the Schedule.

[18] Lastly, much reliance was placed on para 3(2) of the Schedule in support of the Commissioner's contentions. It reads:

'The provisions of paragraph 2 shall apply in respect of all amounts payable by way of remuneration, notwithstanding the provisions of any law which provides that any such amount shall not be reduced or shall not be subject to attachment'.

It was submitted that this is an all-encompassing provision which was intended by the Legislature to entrench the statutory obligation in para 2 of the Schedule. For this reason, so it was contended, para 3(2) takes precedence over all other legislative enactments. A simple reading of para 3(2) in the context of the relevant provisions of the Act, makes it plain that it finds no application here. The Act does not contain 'any provisions . . . which provides that any such amount shall not be reduced or shall not be subject to attachment'. The amount in question here is the remuneration payable to the employees. Section 98A(1)(*a*) merely provides that the remuneration which must be paid ranks as a preferent claim. It does not elevate the statutory obligation to deduct PAYE as a preference above the s 98A payment – the converse, as explained above, is in fact true. Consequently the argument must fail.

[19] The high court's ultimate conclusion in setting aside the Master's decision and directions was therefore correct. Counsel for the Commissioner correctly did not seek to defend para (*a*) of the Master's directions, set out in para 5 above. The PAYE obligation cannot be costs of administration. PAYE is a tax on employees' remuneration. As stated, at the commencement of liquidation the employees' contracts of employment were suspended. Their

claim for payment in respect of each of the three categories therefore emanates from the period prior to liquidation.

[20] The costs of administration and liquidation fall under s 97 of the Act and rank, together with other miscellaneous charges, behind the sheriff's charges and the Master's fees. Self-evidently, those charges, fees and costs arise post-liquidation. To categorize PAYE as costs of administration would have the effect that income tax, attributable to the company's trade before liquidation and which thus becomes payable prior to liquidation, would also be a cost of administration. That is plainly untenable.

[21] In view of the aforesaid conclusions, neither of the Master's directions can stand. The Master should have dismissed the objection to the L&D account. Ordinarily the Commissioner would not be without recourse. In the event that, at the end of the relevant tax year, it appears that PAYE is payable by the employees, the Commissioner may lodge a claim, which was not done in this case.

[22] The appeal must consequently be dismissed. The following order issues:

The appeal is dismissed with costs, including the costs of two counsel.

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S A Majiedt

Judge of Appeal

APPEARANCES:

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